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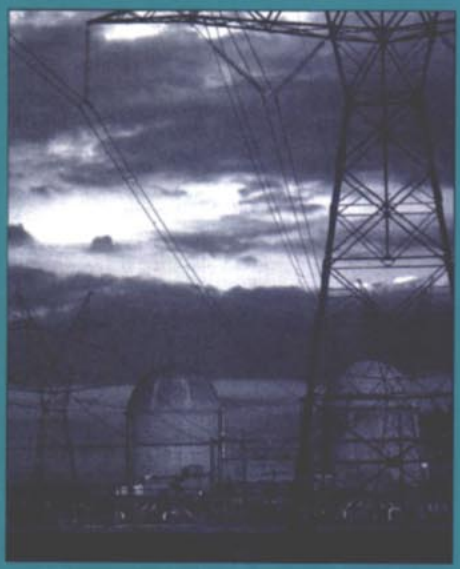

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THE FREEMAN

IDEAS ON LIBERTY

FEATURES

652 **The Central Economic Fallacy of the Century** *by Steven Yates*
The futility—and danger—of government planning.

654 **Aid to Owners of Dependent Enterprises** *by Charles W. Baird*
Ending corporate welfare as we know it.

656 **The Socialist Dream Lives** *by K. L. Billingsley*
The U.N. refuses to face reality.

660 **Global Interventionism and the Erosion of Domestic Liberty** *by Ted Galen Carpenter*
How U.S. foreign policy has harmed the nation economically, socially, and politically.

666 **The Seven Deadly Sins of High Taxes** *by Christopher Lee*
Confiscatory levies work much mischief.

671 **TV Taxes** *by Raymond J. Keating*
Stay tuned as Big Brother continues to meddle.

673 **How Fair Is "Fair Housing"?** *by George C. Leef*
There's nothing fair about coercing property owners.

676 **Technology and the Work Force: Work Will Not End** *by Donald K. Jonas*
Probing the hype and reality of the social pessimists.

679 **Business and Morality in a Free Society** *by Edward W. Younkins*
Capitalism creates an environment in which virtue can flourish.

681 **The Minimum Wage** *by Kevin Sohr and Walter Block*
Rising rates hurt poor, young, and unskilled workers.

683 **Loved to Death: America's Unresolved Health-Care Crisis** *by Michael J. Hurd*
Why "compassionate" government can't meet all our health-related demands.

686 **Electrical Utilities: The Final Deregulatory Frontier** *by Doug Bandow*
How competition could transform an industry.

693 **Edward Coke—Common Law Protection for Liberty** *by Jim Powell*
The legacy of a great English jurist.

COLUMNS

Center *NOTES from FEE*—**Juvenile Delinquency** *by Donald J. Boudreaux*

658 *IDEAS and CONSEQUENCES*—**Educating the Difficult** *by Lawrence W. Reed*

669 *POTOMAC PRINCIPLES*—**Closing Special Interest Government** *by Doug Bandow*

705 *ECONOMICS on TRIAL*—**Great Turnabouts in Economics** *by Mark Skousen*

DEPARTMENTS

650 **Perspective**—Dennis L. Peterson; V. Orval Watts; Leonard E. Read

707 **Book Reviews**

•**Everybody Wins! A Life in Free Enterprise** by Gordon Cain, reviewed by Robert L. Bradley, Jr.; **Dynamics of the Mixed Economy: Toward a Theory of Interventionism** by Sanford Ikeda, reviewed by E. C. Pasour, Jr.; **Everything for Sale: The Virtues and Limits of Markets** by Robert Kuttner, reviewed by Raymond J. Keating; **A Sacred Union of Citizens—George Washington's Farewell Address and the American Character** by Matthew Spalding and Patrick Garrity, reviewed by George C. Leef.

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PERSPECTIVE

Public School Failures, Homeschool Successes

Once almost unheard-of and usually relegated to the province of educational quackery and political or religious radicalism, the homeschooling movement has in the last few years blossomed into a serious educational option. A recent study by the National Home Education Research Institute and the Home-school Legal Defense Association demonstrates just how serious an alternative it has become. Conducted by researcher Dr. Brian D. Ray, the report made a number of startling finds:

- The number of students being home-schooled across the nation is between 1,103,000 and 1,348,000.
- The total number of homeschoolers equals the public school enrollments of the states of Alaska, Delaware, Hawaii, Montana, North Dakota, Rhode Island, South Dakota, Vermont, and Wyoming *combined.*
- Homeschoolers outperform public school students by 30 to 37 percentile points on all subjects on standardized achievement tests.
- Whether the parents ever held a teaching certificate had virtually no impact on student scores. *Even homeschooled students whose mothers never finished high school scored 55 percentile points higher than public school students in similar circumstances.*
- Homeschoolers scored between the 82nd and 92nd percentiles regardless of their families' incomes.
- Students scored at the 86th percentile whether states imposed strict or minimal regulations.
- Homeschooling parents pay an average of $546 per year, whereas the average per-pupil expenditure by public schools is $5,325, excluding all capital costs.
- Homeschoolers' test scores tend to increase the longer they are homeschooled, going from the 59th percentile for those who have been homeschooled for one year to the

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92nd percentile for those who have been homeschooled for seven years.

- More than half (53 percent) of all homeschoolers visit a library at least once or twice a month; 38 percent of them make three to five visits a month.
- The average homeschooled child is involved in 5.2 community activities, such as volunteer work, classes outside the home, group sports, and church. An astounding 98 percent are involved in two or more activities.
- Only six percent of homeschoolers, in contrast to 62 percent of public school students, watch three hours or more of television each day.
- About 61 percent of homeschoolers are in grades K–6, more than 18 percent are in grades 7–8, and almost 20 percent are in grades 9–12.
- Three percent of homeschooling parents intend to continue doing so through grade 6 or less; 89 percent plan to homeschool through grade 12.

In short, homeschooling not only works, but is helping to erode the public school monopoly. The more this message gets out, the more serious will become the homeschooling option.

—DENNIS L. PETERSON

Mr. Peterson is a homeschooling parent and a frequent contributor to The Freeman, Teaching Home, *and other periodicals.*

A copy of the complete study, Strengths of Their Own—Home Schoolers Across America: Academic Achievement, Family Characteristics, and Longitudinal Traits, *may be obtained from the National Home Education Research Institute, P. O. Box 13939, Salem, Oregon 97309, (503) 364–1490.*

Forty Years Ago in *The Freeman* . . .

Leonard E. Read: "Change is a law of all living things. That which is not growing is atrophying; that which is not progressing is retrogressing; that which is not emerging is regressing. *The authoritarian act, or even thought, is time off from growth, progress, emergence.* One cannot be attentive to the inner self while exerting coercion on others. The person who has me on my back holding me down is as permanently fastened on top of me as I am under him. To me, at least, this explains why Lord Acton was right when he said, 'Power tends to corrupt and absolute power corrupts absolutely.'

"For any person to become aware of how little he knows—not a very difficult attainment—is a sure way to reduce the number of authoritarians by one. Who knows? The awareness might even catch on. And, if it did? Millions of us would forsake society's most corrosive pastime—meddling in the affairs of others—meddling not only through the political apparatus, but personally. Millions of us could then concentrate on the wholly rewarding venture of freeing ourselves from our own fears, our own superstitions, our own imperfections, our own ignorance. The individual human spirit, neglected while we play the futile and authoritarian game of imposing our wills on others, cries out for its freedom."

V. Orval Watts: "Every human being's progress depends on the amount of effort that he himself exerts in pursuit of good purposes.

"Among the essential conditions for this effort are the opportunities, the risks, and even the obstacles, of freedom."

—NOVEMBER 1957

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THE FREEMAN
IDEAS ON LIBERTY

The Central Economic Fallacy of the Century

by Steven Yates

The late Murray N. Rothbard once published a major article titled "Ten Great Economic Myths." Included on Rothbard's hit list were the notions that deficits are the cause of inflation and that economists can accurately forecast the future. One myth that he didn't cite dominates Washington today: that the economy can be successfully "managed" from some central point. This idea underlies, directly or indirectly, all of the others Rothbard mentions.

Unfortunately, society's intellectual, political, and economic "mainstream" still accepts what should be called the Central Economic Fallacy of the Twentieth Century. The "mainstream" just doesn't get it. Thus, we continue to see a basic progression. First, government subsidizes *x* or regulates *y* to correct for some government-diagnosed problem *z*. Unwanted side effects result, and *z*, assuming it exists, often grows worse. Government intervenes again to fix the side effects and redouble its efforts to battle *z*. More undesirable side effects result. And the process continues, with government growing inexorably as interventions accumulate. More and more of the economy is micromanaged through increasing webs of subsidy, regulation, and quick fix. The logical end result, as Ludwig von Mises has shown in great detail, is socialism.

Economic micromanagement has been developing at a steadily increasing pace since the Progressive Era, which initiated the social-activist view of government—that only government can effectively address social problems like poverty. Progressivism began a new round of interventions in an economy in which major industries were already well subsidized. Federal Reserve manipulation of the currency—namely massive credit expansion followed by deflation—caused the stock market crash of 1929 and the Great Depression. Then Franklin Delano Roosevelt's interventionist policies deepened rather than relieved the economic crisis. (See, for instance, Rothbard's *America's Great Depression*.)

World War II gave an entire generation of young men and women something to do when there were few jobs at home. But what would veterans do when they returned home? The federal government quick-fixed the problem with the G.I. Bill, creating a new national myth: everyone should go to college. Colleges, rearmed with massive quantities of federal and state dollars, became universities and opened their doors to more and more people. The supply of college graduates in the labor market soared. Soon advanced degrees began to decline in value.

Here we see perhaps the worst feature of the Central Economic Fallacy: massive over-

Dr. Yates is adjunct research fellow with the Acton Institute for the Study of Religion and Liberty and the author of Civil Wrongs: What Went Wrong with Affirmative Action *(San Francisco: ICS Press, 1994).*

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production in certain areas and equally significant shortages in others. (The Soviet economy was only the extreme case of this phenomenon.) In the United States, the growth of university graduate programs has led to a glut of Ph.D's, many of whom are unable to find desired academic employment. This situation has now spread to the hard sciences and includes people such as Alan Hale, co-discoverer of the much-watched Hale-Bopp comet. On the other hand, labor shortages have developed in a variety of occupations not requiring a college degree: carpentry, masonry, and other skilled trades best learned through the apprenticeship and therefore not amenable to the assembly-line approach taken by government-supported schools.

The welfare system is another consequence of the Central Economic Fallacy. The War on Poverty, one of the mainstays of the 1960s, has failed. It left an entire generation with a sense of entitlement and destroyed families by making fathers superfluous. Overall, the system rewarded a range of irresponsible conduct and encouraged dependency, reducing recipients' need to mature, set goals, and become productive members of society. Sons, in particular, lacked responsible role models. An unfulfilled sense of entitlement helped generate resentment and encouraged criminal violence.

Dimly aware that something is wrong, the federal government is now desperately maneuvering to cut at least some of its dependents loose through "welfare reform." Thus far, these efforts do not question the Central Economic Fallacy. For government needs to end, not reorganize welfare, and at the same time dismantle the subsidies and regulations making jobs so hard to come by.

The Central Economic Fallacy has given the country a soaring national debt and myriad job-destroying regulations, diminished the value of higher education, inflamed racial turmoil and other social divisions, pushed taxes upward, devalued the currency ("inflation"), increased the population of chronic dependents, and worsened crime. In fact, as documented by James Bovard in *Lost Rights,* the federal government now undertakes many activities more worthy of a police state than a free society. At the same time, our nation faces serious moral and cultural crises, threatening its very foundations.

For decades, critics of the Central Economic Fallacy have been ignored or dismissed out of hand. But so disastrous have been its consequences that even fans of expanded government have a difficult time denying that the Central Economic Fallacy has run its course. That anything as complex, intricate, and constantly changing as the American economy in the 1990s can be micromanaged from a central point is the overwhelming folly of our time. We have no alternative but to get rid of it. And we have to do so while recognizing that many leaders in academia, business, the media, and politics may never get it. □

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Aid to Owners of Dependent Enterprises

by Charles W. Baird

There is widespread support for ending welfare, and for nudging, or pushing, welfare recipients into self-sufficiency through employment. Congress even voted to end Aid to Families with Dependent Children (AFDC), though President Clinton and the Republican Congress have since backpedaled.

However, there has been no similar attempt to eliminate what might be called Aid to Owners of Dependent Enterprises (AODE). All three levels of government—federal, state, and local—are in the game. The federal government currently spends more than $65 billion a year on what both Representative John Kasich and Ralph Nader call "corporate welfare." State and local governments spend billions more under the euphemism of "industrial development incentives."

For example, the federal government subsidizes commercial ads for companies like the Gallo Winery in foreign countries. The state of California recently sold a former hospital to Sun Microsystems Computer Co. for less than one-half of its fair market value. Both Oakland and San Francisco have given subsidies to privately owned professional football teams to construct and upgrade stadiums.

Dr. Baird is director of the Smith Center, California State University, Hayward.

What Should Government Do?

In a totalitarian state there is no private realm of human action. Every aspect of life is subject to political control. Even if the people who wield public authority are democratically elected, government can be totalitarian.

In a free society, however, government is constitutionally restricted to a set of enumerated powers—i.e., government is limited. Far from having total control, government is kept in its cage precisely so most human action will occur in the private realm. There, individuals are left to pursue their own ends, free from government interference, as long as they do not coerce or attempt to coerce others. Every incursion by government into private affairs, no matter how well-intentioned, is a threat to liberty. AODE is such a threat.

All private enterprises should be free to succeed or fail on their own. When an entrepreneur gets an idea, it is up to him to assemble the necessary resources and turn his idea into action neither assisted nor burdened by government. Success or failure should be determined by the value consumers place on the product or service. The coordination between producers and consumers evident in a market economy emerges spontaneously out of the production-and-exchange activities of millions of individuals, all trying to do the best they can with the limited resources and knowledge they have. Prices of inputs and outputs, and the profits and losses that result,

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are signals that direct individuals into the most socially beneficial activities. Any government interference with this market process, beyond enforcing the rules of voluntary exchange, distorts those signals, and thereby impedes, or even cripples, the process.

All government agencies are staffed by human beings. The sum of the economically relevant knowledge possessed by separate individuals in an economy is always far greater, and more accurate, than the sum of such knowledge possessed by individual bureaucrats in any government agency. Thus, while markets do not generate perfect outcomes, governments inevitably make far more mistakes than do markets.

What to Do?

AODE takes at least four forms: tax breaks, financial aid, regulatory relief, and protection against competition. General tax breaks applying to all firms are always desirable. Americans are overtaxed: federal, state, and local taxes consume over 40 percent of national income. All taxes—income, sales, excise, death, capital gains, property, and payroll (and any I have omitted)—should be reduced. But they should be reduced for everyone, not just for a specific firm or a specific industry.

For example, the federal government gives tax breaks worth $500 million a year to producers of ethanol, a corn-based substitute for gasoline. Seventy percent of that goes to one company—Archer Daniels Midland, a $10 billion agribusiness. This is AODE at its worst. Of course, people like Ralph Nader and Robert Reich who criticize business tax breaks really only want to increase taxes. So targeted tax breaks should be eliminated only if the resulting revenue increase is handed back to taxpayers through general tax cuts. Killing the $500 million ethanol boondoggle could finance a small reduction in, say, the payroll tax.

Financial aid to specific firms and specific industries—whether in the form of direct cash payments, below-market interest rates on loans, or direct payments for training of employees—by any level of government is never justified. All such subsidies should be terminated and taxes cut accordingly. For example, eliminating just half the business subsidies in the federal budget would free up enough money to completely eliminate the federal capital gains tax.

Reductions in regulations, except those which proscribe coercion, are always desirable. States that try to lure businesses by offering better regulatory environments deserve applause. Even regulatory breaks for only specific firms warrant support, since once a state starts lifting the regulatory burden, even for one firm or one industry, interstate and inter-local rivalry will encourage the practice to spread.

Of course, such competition bothers some analysts. For instance, Melvin Burstein and Arthur Rolnick, economists at the Federal Reserve Bank of Minneapolis, have urged Congress to use the Commerce Clause of the Constitution to outlaw interstate competition aimed at attracting investors. They argue that the cost of such "economic war among the states" takes money away from legitimate public goods. But the set of legitimate public goods on which states should spend more money is either empty or nearly empty. Moreover, the original intent of the authors of the Commerce Clause was to knock down state interferences with free movements of goods, services, and resources among the states. The one good aspect of state (and local) AODE is to lower taxes and regulations, thereby encouraging interstate mobility of goods, services, and resources. Congress ought to exercise its legitimate Commerce Clause powers to encourage states to generalize the tax and regulatory incentives they now offer to particular firms and particular industries. This would promote interstate commerce.

Another form of AODE is protecting specific competitors against competition. For example, the federal government imposes steel import quotas to protect domestic producers from foreign competition. This one item costs the American economy around $7 billion a year in the form of higher prices for steel and products produced with steel. The state of California regulates the amount of land that can be used to produce navel oranges in order to shield incumbent growers

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from competition and limit price competition. New York City prohibits private vans and jitneys from competing with city-franchised and/or city-owned, monopoly transit systems. None of these restrictions are justifiable, since they benefit the few at the expense of the many. Such policies are, to quote economist Dwight Lee, "malice in plunderland."

In sum, we should end corporate welfare as we know it. However, we should not permit this worthy idea to be misused to increase government intervention. End the subsidies. Convert specific tax breaks to general tax reductions. Convert specific regulatory breaks to widespread regulatory relief. Finally, get all governments out of the business of protecting particular competitors and into the business of protecting competition. In short, rebuild the Founders' original wall of separation between the public and private realms of human action. □

The Socialist Dream Lives

by K. L. Billingsley

The United Nations development agency recently rated nations on how they combat poverty, thereby providing valuable lessons in economics, politics, and even diplomacy.

At the head of the list stands Trinidad and Tobago, a tiny Caribbean nation noted mainly for tourism. The islands' economy cannot provide enough jobs for its citizens, who emigrate in search of work. How the U.N. developers came up with Trinidad as the model poverty fighter remains mysterious but their second-place ranking, Cuba, provides some clues.

Before the demise of the Soviet Union, the Marxist-Leninist Cuban regime of Fidel Castro, the world's longest-running dictator, fought even the communist reforms of glasnost and perestroika. The USSR duly passed into history and its Eastern Bloc colonies began throwing off their chains, trading the crackpot theories of Karl Marx for the free-market economics of Ludwig von Mises and Friedrich Hayek. But in Cuba, Fidel remained true to the socialist faith, even without the billions in annual Soviet subsidies.

While other Latin American nations turned to democracy and capitalism, Cuba not only rejected the free-market reforms but cracked down on private activity and political dissent. Alone in the hemisphere Cubans suffered rationing and true deprivation. By Cuban statistics, the country's GNP has fallen by about 20 percent, with the true figure likely much worse. The average Cuban worker, according to the island's government, earns 203 pesos a month, which at official rates translates to about $140 per year.

For a time they had used various walls in Havana as a posting board for classified ads. But when this proved too popular, Cuba's communist government banned the practice as a "vestige of capitalism." Most recently, the regime has declared Havana off-limits to those streaming in from the countryside in search of work and food. Contrary to what the regime's foreign apologists maintain, the U.S. embargo does not explain the island's plunge into an abject poverty rivaling that of Haiti.

There is nothing the United States makes

K. L. Billingsley is a journalism fellow at the Center for the Study of Popular Culture in Los Angeles.

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that Cuba cannot freely buy from other nations, which have lately been investing in Cuba in defiance of U.S. policy. Canada's Sherrit International Corporation has invested $675 million in Cuba. Of the annual $10,000 Cuba gets for each Sherrit worker, the government keeps $9,784, a tax rate of 97 percent. Yet Cubans, now desperate to survive, line up for the jobs.

Any sober analysis reveals Cuba as a destroyer of wealth and a creator of poverty. A regional economic power before Castro, the regime has caused its citizens to flee by the thousands, often risking their lives to do so, leaving loved ones behind. That should come as no surprise because Marxism-Leninism is history's greatest creator of poverty, misery, and mass death. Nations that are barren of liberties are also barren of groceries. Yet the United Nations development agency ranks Cuba ahead of Chile, Singapore, and Costa Rica, which far outstrip it in wealth.

According to the U.N., nations can eliminate poverty by "combating gender inequality," and "narrowing the differences between genders and social classes," along with "reforming trade policies," areas in which Cuba apparently ranks high. But those countries that have increased national wealth and actually lifted people from poverty have done so by the very means rejected by Cuba, the free market, individual responsibility, privatization, and low government regulation.

If the U.N. truly wanted to help nations lift their citizens from poverty, it would advance these proven measures and oppose the statist dictatorships. Instead, the U.N. offers tired political and bureaucratic solutions, proving once again that the socialist dream can thrive even when the evidence against it stands stronger than ever.

For the world's poor that is a tragedy and there seems little reason American policymakers should support an international bureaucracy which rewards dictatorships for having created poverty while downgrading productive democracies that have created wealth. □

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Educating the Difficult

Whenever the issue of "school choice" comes up for discussion, somebody inevitably will claim that the private sector can't be trusted to serve the kids who are, for one reason or another, difficult to educate. Government schools are depicted as democratic, egalitarian institutions that take on all comers, including the toughest cases. Private alternatives are alleged to be inherently elitist organizations that "skim the cream" and leave the challenging kids to their courageous and altruistic public counterparts. This perspective is pure myth.

The fact is that children who are troubled, neglected, learning or emotionally disabled, or otherwise have special needs are often not well served in the conventional public school setting. They need help from nongovernmental sources, from people who know that you don't have to be a civil servant to be either civil or a servant.

The private sector, including private sectarian schools, religious schools, nonpublic agencies, and homeschools, offers a wide variety of education programs for this difficult-to-educate population. When public schools or agencies cannot serve a particular student, they sometimes contract with a private-sector body to do the job. The Directory for Exceptional Children lists roughly 3,000 special-education schools and facilities in the private sector nationwide. Their costs of educating a student vary widely, depending in large part on the nature of the disability category served, and may also include the cost of medical care and transportation.

Examples include Sobriety High in Edina, Minnesota, which educates 9th through 12th-grade students in recovery from chemical dependency. The famed Boys Town, based in Nebraska, directly cares for more than 27,000 boys and girls each year in 14 states and the District of Columbia. The Helicon Shelter Education Program, a division of Children's Comprehensive Services, provides certified teachers, materials, curriculum, and academic record-keeping on site at 27 emergency foster-care shelters throughout the state of Tennessee.

According to a study from the Reason Foundation in Los Angeles, about half of the nation's children who suffer from traumatic brain injuries are placed in private settings. Students with Serious Emotional Disturbance (SED) account for 40 percent of the disabled students enrolled in nonpublic schools. Private-sector institutions are providing education for the mentally retarded, the autistic, the deaf and blind, and those with orthopedic impairments as well. Some of these institutions decline government support, but many do not.

Roman Catholic Church organizations alone operate nearly 200 schools throughout the United States specializing in educating children with disabilities. Among them are the St. Lucy Day School in Pennsylvania for children with visual impairments; the Mary

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Immaculate School in Toledo, Ohio, which serves learning disabled and children affected by crack cocaine; and St. Coleman's Home in New York for children with autism and emotional disturbance.

According to Tom Bushnell, president and director of the National Challenged Homeschoolers Associated Network, some 30,000 American children with disabilities are homeschooled. Says Bushnell, who personally homeschools a blind daughter, a child with Down's syndrome, and a child with cerebral palsy, "Sometimes it's easier to do it yourself than fight. When you have to go to an IEP (Individualized Education Plan) meeting and face a multidisciplinary team of six or eight professionals, it's stressful. It's you against the world. Parents get tired of fighting." And, says Bushnell, parents sometimes worry that the adversarial relationship with the public schools will affect the quality of care the schools give their child. "Would you want someone who you had to fight in an IEP meeting to put a catheter into your child?"

The Reason Foundation report quotes another homeschooling parent, Devorah Weinmann. After the local public school psychologist refused to allow Weinmann's learning-disabled daughter to start school one grade level below her age group, this dedicated mother opted to do the job herself and explained her decision this way: "She (her daughter) had been through five [foster care] placements by the age of four-and-a-half. She went through hell and back to become fairly secure. [The schools] weren't looking at her as an individual. . . . She would just be shuffled along until she failed. I said, 'I'm not doing this.' "

In Michigan, private-sector help for difficult-to-educate children is a story crying to be told. A report from the Mackinac Center for Public Policy is now helping to tell it. For example: the Manor Foundation in Jonesville is both a residential school and a treatment facility that admits children with problems that include pervasive development disorder, early infantile autism, schizophrenia, impaired hearing, and even the trauma of sexual abuse.

Starr Commonwealth, an Albion-based organization with six Michigan sites, has been serving children and families since 1913 as a private-sector alternative for violent, troubled, and dispossessed children. It raised more than $15 million from private sources in a recent year.

St. Peter's Home for Boys in Detroit, operated by the Episcopal Diocese of Michigan, provides residential care and schooling for boys between ages 11 and 19 who require placement outside their homes. The Home's mission is deeply rooted in an emphasis on the dignity of each individual that arises out of explicit ethical standards.

Our Lady of Providence Center in Northville admits mild, moderate, and severe cases of developmentally disabled girls over the age of 10 and women under 40 in its residential program and school. Its acclaimed programs that teach self-help and work skills alongside spiritual values have benefited hundreds since 1957.

The problems these and other private institutions are solving are often problems no government organization would be equipped to address with maximum effectiveness, even if it were legal for it to try. Those situations, which require spiritual guidance and restoration of moral values rooted in a religious context, are simply beyond the reach of public employees.

Difficult-to-educate students present multiple challenges to educators and policymakers. The public schools serve the majority of these students, but they do not educate everyone. Often in partnership with public schools and public agencies, but sometimes operating entirely on their own through exclusively private support, nonpublic schools and organizations are meeting the special needs of a great number of students. As Americans continue to debate the direction of education reforms, they should not sell short the achievements of these private institutions. □

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THE FREEMAN
IDEAS ON LIBERTY

Global Interventionism and the Erosion of Domestic Liberty

by Ted Galen Carpenter

"Perhaps it is a universal truth that the loss of liberty at home is to be charged to provision against danger, real or pretended, from abroad."

—JAMES MADISON TO THOMAS JEFFERSON
May 13, 1798

There is a tendency of many people to separate domestic and foreign issues. For instance, many supporters of the free market advocate government activism abroad. But categorizing issues as "foreign policy" or "domestic policy" can be artificial and misleading. Developments in one arena frequently interact with and affect developments in the other. Most analyses of this phenomenon have focused on how domestic attitudes and interests influence the style and substance of foreign policy. Less attention has been paid to the opposite phenomenon—the impact of foreign policy aims or requirements on domestic institutions and practices. Yet that feedback may ultimately have a more important impact on the health of American liberties.

The foreign policy of the United States has obviously changed dramatically since "isolationism" held sway at the end of the 1930s. Over the past half century, the republic has acquired and maintained a host of global political and military commitments. Washington has linked America's security to that of the other hemispheric nations through the Rio Treaty and has done the same with Western Europe through NATO. It has negotiated multilateral pacts such as ANZUS (with Australia and New Zealand) and concluded bilateral security treaties with such nations as Japan, South Korea, and Pakistan.

Such formal arrangements, however, do not fully measure the extent of U.S. obligations in the world. The Truman Doctrine, promulgated in March 1947, pledged the United States to assist other nations confronting either external aggression or subversion by "armed minorities." Washington attached no discernible geographic limits to that promise of assistance, and it served as the explicit or tacit basis for U.S. involvement in numerous Third World struggles throughout the Cold War. In the late 1950s, the Eisenhower Doctrine committed the United States to "secure and protect the territorial integrity and political independence" of Middle Eastern nations from "any nation controlled by International Communism." The so-called Carter Doctrine, proclaimed in early 1980 following the Soviet invasion of Afghanistan, made the United States the gendarme of the Persian Gulf. That commitment, which was fulfilled on a grand scale during the Persian Gulf crisis of 1990–1991, remains in effect. In addition to the presidential doctrines, the United States has informal but real security arrangements with Israel and several other countries.

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All told, the United States is committed to help defend dozens of nations. Moreover, growing U.S. involvement in peacekeeping operations authorized by the U.N. Security Council (most notably in Somalia) and "out of area" operations conducted by NATO (as in Bosnia and Macedonia) is likely to increase the total. That expansion of obligations is most evident in the Clinton administration's plan to enlarge the membership of NATO to include several Central European nations—and perhaps someday most East European nations as well. Five decades after the dawn of the Cold War, and more than six years after the end of that bitter rivalry, U.S. foreign policy remains interventionist on a global scale.

This policy has had a pervasive impact on the Republic's domestic affairs. In ways both obvious and subtle it has transformed the nation economically, socially, and politically. Some of those changes are unarguably positive. Concern about how America was perceived throughout the world—especially in the emerging nations of Asia and Africa, in which the United States was competing with the Soviet Union for influence—was a significant factor impelling political leaders to abolish the legal framework of racial segregation in the 1950s and 1960s. The odious Jim Crow system probably could not have endured in any case, but the fact that it was a liability to American foreign policy undoubtedly hastened its demise.

Other domestic changes caused or at least facilitated by Washington's policy of global interventionism, though, have been far less benign. The early twentieth-century social critic Randolph Bourne observed that "war is the health of the state," by which he meant that governmental power inexorably expanded at the expense of individual freedom during periods of armed conflict. Robert Higgs's seminal work, *Crisis and Leviathan: Critical Episodes in the Growth of American Government* (1987), documented that observation, showing how many of the powers now routinely exercised by the federal government were not acquired during such spasms of domestic "reform" as the Progressive Era, the New Deal, and the Great Society. Instead, they emerged because of national mobilizations to fight the two world wars. Moreover, the New Deal and the Great Society were explicit attempts to replicate in peacetime the mobilization of human talent and natural resources that had occurred during wartime.

Enhanced State Power Remains

Even when the nation terminated its war mobilizations, a sizable residue of enhanced governmental power always remained. Manifestations of that "wartime" authority would later surface during peacetime—often in unexpected ways. For example, President Richard Nixon based his 1971 executive order imposing wage and price controls on an obscure provision of the Trading with the Enemy Act of 1917, enacted during the early days of World War I but still in effect decades later.

These surviving wartime powers have also been an important factor in the permanent expansion of the size and scope of the political state. One "temporary" measure enacted during World War II was the withholding provision of the federal income tax. That device has had the insidious effect of disguising the true tax burden on most Americans by "painlessly" extracting the money from their payroll checks before they get an opportunity to see (and use) those funds. For such taxpayers the category of gross salary or wages is little more than a meaningless bookkeeping entry on their payroll check stubs.

One suspects that citizens would be decidedly less willing to carry their current bloated tax burden if they had to write annual or quarterly checks to the IRS. Indeed, it is likely that there would have been a massive tax revolt long before the federal government began consuming more than a quarter of the nation's gross domestic product. It seems more than a coincidence that the two groups that are not subject to the anesthetic of withholding taxes (sole proprietors and independent contractors) have most militantly opposed high taxes. A wartime innovation has thus become an important permanent building block of the leviathan state by continuing

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to conceal the real tax burden from most Americans.

Perpetual Crisis

Bourne's observation about war being the health of the state is not sufficient, however. It is not only an actual state of war that creates the regimentation and massive violations of civil liberties he feared. An atmosphere of perpetual crisis and preparation for war can produce the same result. The creation of a national security state to wage the Cold War produced many of the same domestic problems and distortions associated with periods of actual combat in earlier eras. America has been essentially on a war footing for more than half a century, and the result has been a significant erosion of liberty. Perhaps most ominous, the end of the Cold War has not produced a retrenchment in either the nation's foreign policy or pervasive garrison-state mentality.

There are numerous examples of undesirable changes in America's domestic system brought about by Washington's global interventionist foreign policy. Waging the Cold War led to the creation of a large and expensive military establishment. Despite the end of the Cold War, military spending (currently $268 billion a year) consumes nearly four percent of America's GDP. U.S. military outlays dwarf those of other industrialized countries. For example, Japan spends just $45 billion and Germany a mere $30 billion. Each American must pay more than $1,000 a year to support the military; the burden for each German is about $260 and for each Japanese about $240. That huge disparity is one tangible measure of the financial costs of sustaining a foreign policy based on maintaining U.S. global "leadership" and responsibility.

In addition, government continues to guide the American economy in the name of national security, much as it would during a wartime mobilization. In marked contrast to the pre-World War II era, the national security apparatus wields considerable economic power. The emergence of multibillion-dollar defense firms whose principal (and, in some cases, sole) customer is the Pentagon is testimony to that fact. There are also restraints on commerce that would have been unthinkable only a few decades ago. Embargoes have been imposed on trade with certain countries deemed to be adversaries of the United States—including such a mortal threat to American security as Burma. In addition to such formal sanctions, there exists a variety of restrictions on the export of technologies that the government decides (often arbitrarily) could have military applications or national security implications. The tug of war between the Clinton administration and the business community over encryption policy is only the most recent example.

An interventionist foreign policy has not only facilitated the expansion of federal governmental power at the expense of the private sector, but has also produced ominous changes within the federal government itself. The conduct of foreign affairs during the Cold War enhanced the power of the executive branch to an unhealthy degree. Fulfilling global obligations placed a premium on the reliability of Washington's commitments as well as the speed (and often the secrecy) of execution. The procedural demands of an interventionist foreign policy are fundamentally incompatible with the division of responsibilities and powers set forth in the Constitution and generally adhered to throughout America's history. Extensive congressional participation in the foreign policy process involves the possibility of delay, the disruption of national unity, and the creation of doubts about the nation's constancy.

The Imperial Presidency

Maintaining a global interventionist policy has led inexorably to the emergence of an "imperial presidency." Chief executives have grown accustomed to using the military according to their personal definitions of the national interest, frequently without even the semblance of congressional consent. The congressional war power, stated in clear and concise terms in the Constitution, has become moribund. Harry Truman's unilateral decision to commit more than 300,000 U.S. troops to the Korean conflict in 1950 remains the

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most brazen episode of the imperial presidency, but it was hardly the only one during the Cold War. Nor has such executive usurpation of the congressional authority over matters of war and peace abated now that the Cold War is over. The Clinton administration's dispatch of 20,000 U.S. troops to Bosnia as part of a multilateral peacekeeping and nation-building mission confirms that the imperial presidency is alive and well.

The consequences of interventionism are not confined to changes in the nation's political and economic systems. Individual citizens find their liberties circumscribed in a variety of ways. Throughout most of our history, Americans routinely exercised the right to travel outside the country without having to beg permission from Washington. That has changed dramatically during the past half century. Foreign travel and participation in events held in other nations are no longer an inherent right of American citizenship; such activities are often used as pawns to serve foreign policy objectives. Certain countries are declared off-limits to U.S. citizens if Washington deems it in the national interest, and ostensibly nonpolitical events such as the Olympic Games have become tools of diplomacy. Americans whom the government brands as threats to national security are subjected to passport revocations and various forms of harassment.

Undermining Foreign Policy Debate

The garrison-state mentality fostered by an interventionist policy leads to practices that undermine both the legitimacy and the feasibility of debate on defense and foreign policy issues. Indeed, policymakers habitually regard public or congressional scrutiny as an obstacle to be avoided or removed. To thwart such oversight, they have sought to maintain a monopoly of information by misusing the secrecy classification system. Information that contradicts official versions of events or might cast doubt on the wisdom, legality, or morality of a presidential policy is kept from the prying eyes of potential critics. The cult of secrecy surrounding defense and foreign policy issues has evolved as an indispensable corollary of global interventionism. As Washington's overseas commitments have grown, so too has the scope of information—including much that is essential to any public debate on foreign policy options—concealed from the American people and even their congressional representatives.

Interventionism has not only encouraged foreign policy elitism and secrecy, but has also promoted a pervasive intolerance of alternative views on national security issues. Too often, dissent has been viewed as synonymous with disloyalty. The McCarthy era in the early and mid-1950s was the most infamous example of an intolerant loyalty crusade, but it was hardly unique. Precedents for what became known as McCarthyism were established during and immediately following World War I as well as the period just before American entry into World War II. Moreover, the Truman administration utilized the politics of loyalty even during the earliest stages of the Cold War to quash dissent.

The practice of smearing and harassing foreign policy critics did not expire with the junior senator from Wisconsin. The FBI, the CIA and other intelligence services, and even elements of the military conducted sophisticated programs to spy on, disrupt, and discredit opponents of the Vietnam War. And they usually did so with the full knowledge and approval of high-ranking officials in the Johnson and Nixon administrations. Disclosure of such tactics led to reforms designed to prevent a repetition, but events during the Reagan years indicated that those changes were largely ineffectual. Evidence surfaced that opponents of the administration's Central America policy were routinely harassed by agents of the Customs Service and the FBI upon returning from trips to that region. Even more disturbing were revelations that the FBI secretly investigated the Committee in Solidarity with the People of El Salvador (CISPES) for more than two years despite a dearth of evidence that the group was engaged in any unlawful activities. Congressional allies of the Bush administration smeared critics of the Persian Gulf War as apologists for Saddam Hussein.

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Managing the News

Because dissent is often equated with disloyalty, the national security bureaucracy has waged a determined effort to co-opt, intimidate, and exclude the press on foreign policy issues, since members of the news media who question the logic of policy decisions or the veracity of officials raise doubts about the wisdom of U.S. globalist strategy, thereby sowing division among the American people. That is especially true of those individuals who dare to penetrate the veil of secrecy and reveal evidence that might discredit that strategy.

During both world wars and the first two decades of the Cold War, the government primarily sought to enlist the press as an instrument of the nation's foreign policy, and did so with considerable success. (Although officials preferred to stress co-option, even in those periods the threat of intimidation, exclusion, and outright censorship lurked in the background.) As the press became more critical of U.S. policy during the Vietnam War, confrontation increasingly replaced co-option. During the Nixon administration, reporters who published stories based on leaked classified information were threatened, together with their sources, with prosecution for espionage. The alleged authority for such prosecutions was a statute, passed in the initial stage of World War I, that was aimed at preventing spies from giving militarily relevant information to enemy governments. A campaign to treat embarrassing disclosures as a form of espionage re-emerged during the Reagan and Bush administrations, and the government scored an ominous legal victory by successfully prosecuting defense analyst Samuel Loring Morison for the "crime" of leaking classified information, not to a foreign government, but to Jane's *Defence Weekly*.

In addition to resurrecting that technique of intimidation, the national security bureaucracy found an ingeniously effective method of stifling hostile press coverage of military operations. When the United States invaded the tiny Caribbean nation of Grenada in the autumn of 1983, the Pentagon simply barred the media. For more than 48 hours, the government enjoyed the luxury of exercising absolute control over information about a significant and controversial military operation. In so doing, it established a tempting precedent for an exclusionary policy to be invoked in similar—and perhaps far larger and more prolonged—interventionist enterprises. Indeed, when U.S. forces invaded Panama in December 1989, the techniques used in Grenada were applied again, albeit in a slightly more subtle fashion. Reporters were delayed and kept away from the scenes of military action and were instead given guided tours of such important sights as Panamanian dictator Manuel Noriega's pornography collection.

Government manipulation of the media reached its apogee during the Persian Gulf War. Military officials herded reporters into organized pools monitored by "public affairs" personnel and barred them from attempting to reach front-line areas on their own. Meanwhile, correspondents were fed a steady diet of briefings (i.e., propaganda) by the military, replete with videotapes showing the clean-kill capabilities of smart bombs and other high-tech U.S. weaponry. The press corps became little more than a transmission belt for the Pentagon's version of events. Consequently, the American public saw astonishingly little of the bloody reality of the war (especially the extent of Iraqi casualties) and learned even less about the complex roots of the Gulf crisis.

The politics of loyalty, the pervasive cult of secrecy, and governmental attacks on the press all have one thing in common. They have the effect (and perhaps the intent) of hobbling public debate on both the substance and the execution of U.S. foreign policy. A strategy of global interventionism, to be effective, requires domestic unity and conformity. Those requirements run directly counter to the values of political pluralism and unfettered debate so essential to the maintenance of a democratic system. An interventionist foreign policy promotes the growth of a centralized and remote political structure, creates economic regimentation, and undermines a variety of civil liberties, especially freedom of expression.

Another ugly manifestation of interven-

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tionism was the policy of conscripting young Americans into the military and sending them off to fight in distant wars. That infringement on their liberty was exacerbated by the fact that most of those struggles were murky geopolitical conflicts that bore little if any relevance to America's vital security interests. Many of the unfortunate conscripts returned home maimed in body or mind; many others failed to return at all.

The military draft became an important device to sustain an interventionist strategy in both world wars and throughout the most virulent stages of the Cold War. It also became the quintessential symbol of the domestic regimentation that global interventionism promotes. It is no coincidence that ardent global interventionists are usually among the most relentless supporters of efforts to restore conscription, either directly or in the guise of a more comprehensive national service system.

"For the Security of the Nation"

Perhaps the most corrosive domestic effect of Washington's interventionist foreign policy has been on national attitudes. Americans have come to accept governmental intrusions in the name of "national security" that they would have ferociously opposed as blatant power grabs in earlier eras. Politicians gradually learned that the fastest way to overcome opposition to schemes to expand the state was to portray initiatives as necessary for the security of the nation. Sometimes such reasoning has been exceedingly strained. The statute that first involved the federal government in elementary and secondary education was titled the National Defense Education Act. Similarly, the legislation funding the interstate highway system was the National Defense Highway Act. It is surprising that the sponsors of Medicare didn't fashion their bill as the "National Defense Elderly Care Act."

Not only has the national security justification been cynically used to defuse opposition to mundane welfare state and traditional pork-barrel initiatives, the rhetoric of war has come to dominate the national discourse to an unhealthy degree. We have seen the "war" metaphor used promiscuously, including Lyndon Johnson's War on Poverty, Jimmy Carter's Energy War, the war on drugs, and more recently "wars" on cancer and illiteracy. Language matters, and the fondness for such rhetoric is a revealing and disturbing indicator of how deeply the garrison-state mentality has become entrenched.

The adverse domestic consequences of global interventionism raise serious questions about the future of individual liberty in the United States. At the dawn of the Cold War, social commentator Garet Garrett warned that America could not indefinitely remain a republic at home while taking on the trappings of empire abroad. He noted a fundamental contradiction between the desire to play the role of global policeman and the objective of maintaining long-standing American traditions of limited government, free enterprise, and individual liberty. Garrett's warning is even more applicable today. Americans are rapidly reaching the point where they must confront a stark choice. Either the United States will adopt a more circumspect role in the world in order to preserve domestic freedom, or that freedom will continue to erode (perhaps beyond the point of recovery) to satisfy the requirements of a globalist foreign policy. That choice will determine not only how the United States is defended but whether this country retains the values and principles that make it worth defending. □

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THE FREEMAN
IDEAS ON LIBERTY

The Seven Deadly Sins of High Taxes

by Christopher Lee

By justice a king gives stability to the land, but he who imposes heavy taxes ruins it.

—PROVERBS 29:4
(New American Bible)

In a free society government has an important but limited role to play. Adam Smith, for instance, acknowledged the necessity of providing national defense, maintaining law and order, implementing a system of weights and measures, as well as defining and protecting property rights. Further, he advocated government provision of goods for which there were substantial positive spillovers, though experience has led many modern classical liberals to question the appropriateness of this role. Even in Smith's vision, however, the ultimate public good is a nurturing environment within which voluntary exchange can flourish. Government should be umpire and rule maker, not participant, in the economy.

Of course, to perform any of these functions government requires taxes. All taxes are costly, since they divert resources from other useful purposes. Moreover, most taxes distort the economy. The deadweight costs associated with the tax wedge are a fact of life. If government were to concentrate on its proper objectives, it is likely that the benefits of government operations would outweigh its costs. But government is now far too large, and is generating more costs than benefits.

A 1995 International Monetary Fund study concluded that every one percent rise in taxes cuts GDP output per worker by about two percent. In the same year Congress's Joint Economic Committee estimated a deadweight cost of 40 cents per dollar of additional government spending. An earlier analysis published in the March 1985 *American Economic Review* figured the deadweight cost per dollar of tax to be between 20 and 50 cents. Not surprisingly, high-tax U.S. cities are losing jobs to low-tax cities and high-tax states are losing jobs to low-tax states. Similarly, countries with highly interventionist governments are growing more slowly than countries with less state intervention.

The perceived benefits of government are well understood. The distorting effects of taxes are generally less visible. These could be called the seven deadly sins of high taxes.

1. Favoring leisure over work.

Few people would work as hard as they do for as long as they do except for the fact that they receive payments which can be exchanged for goods and services. Most would consume more leisure if its price were lower, just as they would consume many other goods if their prices were lower.

The price of leisure is the income forgone

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when one does not work. In a mythical no-tax world in which one could earn $10 per hour, $10 would also be the price of an hour of leisure. But taxes change that. With a 30 percent marginal tax, the price of leisure artificially falls to $7 because that is all one gets to keep after taxes. This increases the consumption of leisure. Yet it is work that is necessary to create wealth (which, ironically, ultimately makes more leisure possible). The size of the economic pie is arbitrarily reduced.

2. Work takes inefficient forms.

A capitalist economy is a positive-sum game. As a result of free exchange, the size of the economic pie is continually increasing. One reason for this is the phenomenon of economic specialization. People tend to specialize in those activities in which they have the greatest comparative advantage, thereby increasing their output. They then obtain the other things that they desire through exchange.

Consider an accountant in a mythical zero-tax world. If he earns $25 an hour, he will hire other people to mow his lawn, paint his house, and perform similar tasks so long as they charge less than $25 an hour. But taxes change this. With a 50 percent marginal tax, the accountant ends up earning only $12.50 for every additional hour of work. Instead of hiring a painter who charges, say, $15 an hour, the accountant will paint his own house. In this example, this results in a loss of economic output to society of $10 an hour.

3. Favoring consumption over investment.

Consider an individual living in our mythical tax-free world who is attempting to decide whether he or she should invest $10,000, and thereby earn $700 per year forever, or spend the $10,000 on a vacation. He cannot decide between the two because, in the language of economics, he is indifferent.

Taxes change that. Suppose a tax of 50 percent on marginal income is imposed. Now a $10,000 investment will generate only a $350 income stream. If he was indifferent before, he will choose the vacation now. As a consequence, high taxes reduce the opportunity cost of consumption relative to investment, reducing the capital stock and ultimately economic growth.

4. Reducing respect for the law.

When government concentrates on its core functions, taxes are relatively low and the benefits are clear. As a consequence, tax evasion is minimal. But as government grows, it tends to operate increasingly for the benefit of one group at the expense of another. People feel less moral imperative to pay their taxes. Some lobby for "loopholes" and other tax breaks. Others creatively "interpret" the law. And higher tax rates increase the financial return on avoidance and cheating.

Today, *Money* magazine estimates that tax resistance denies the government $150 billion annually. It is not a much larger step from tax evasion to broader disregard of the law. Yet stricter enforcement measures both threaten individual liberty and consume valuable economic resources: as a result, the size of the economic pie is again made smaller.

5. Encouraging the development of the underground economy.

A related impact of higher taxes is the people's desire to put commercial transactions "off the books." It has been estimated that the following percentages of services are supplied by the underground economy and escape taxation.

Lawn and garden maintenance	90 percent
Domestic help	83 percent
Child care	49 percent
Home repair/improvements	34 percent
Laundry/sewing services	25 percent
Appliance repairs	17 percent
Car repairs	13 percent
Haircuts/beauty services	8 percent
Catering	8 percent

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It is, of course, difficult to estimate the total output of the underground economy. Estimates range from 4 to 25 percent of GDP. Even 10 percent would represent $700 billion. Moreover, nations with higher tax rates, such as Italy, have even larger underground economies.

Commercial activity hidden from the tax collector represents a drag on the economy. It takes an effort to remain undetected. Payments must be "washed" or otherwise hidden from view. Double sets of books must be maintained. Often vendors are unable to maintain permanent retail establishments or advertise normally. In addition, respect for the law again is reduced. Indeed, the very nature of such secret activities, and the likelihood of coming into contact with others engaged in similarly illegal activities, may facilitate the expansion into genuine criminal enterprises.

6. Encouraging nonproductive rent-seeking.

One can acquire resources from one another through voluntary exchange or coercive transfer. Voluntary exchange is a positive-sum game, increasing the wealth of everyone involved. Coerced transfers, however, make everyone worse off. The case of theft is obvious: not only are resources devoted to commit crimes and defend against crime, but goods are taken away from those who value them the most and use them most efficiently.

Forced transfers through the political process—what goes on in Washington every day—have a similar impact. As government collects, and hands out, more money, various groups have a greater incentive to try to become a beneficiary of government largess and to protect their wealth from the attempts of others to gain from coerced transfers. Practical evidence of this effect is the steady move of corporations and associations to Washington, D.C., the growth in the number of lobbyists, and the steady increase in campaign contributions and spending.

7. Fostering envy.

An egalitarian society will also be a poor society. No society has yet found a way to induce individuals to work hard, invest in human capital, and engage in enterprises for uncertain profits if they are unable to earn a differential return. But these are all essential elements of wealth creation. In short, unequal income distributions are necessary for economic growth which benefits all people, poor and rich alike. (Of course, the poor in the United States today are poor only relative to the rich in the United States. Compared to people through human history, the poor are rich indeed.)

In a market economy one can, with considerable conviction, maintain that income is not "distributed" in the sense that social planners use that term. Income is earned through a combination of hard work, imagination, and faith in one's ideas and in the future. Eighty percent of those who make up the Fortune 500 list represent "new," not inherited, wealth. As such, the money belongs to those who earned it and should not be forcibly redistributed by government. Even if the rich have a duty to give to the poor, other people have no right to steal, acting either as individuals or collectively through government.

But when the government starts to make widespread wealth transfers both directly by taxing and spending and indirectly by regulating, it inflames envy. In such a world, many people believe that they have a claim not only to a portion of the nation's overall wealth, but to the wealth of anyone earning more than them. Society risks slipping back into the jungle described by Thomas Hobbes in *Leviathan*, in which work is in vain because the fruits thereof will be taken from the producer.

When properly constrained, government can be a productive institution. Even then, it should perform its functions with utmost efficiency and minimal economic distortion. But we have gone well beyond the point of positive marginal benefits and that improvement now requires a much smaller government. In deed as well as word we need to resolve that "The Era of Big Government Is Over." □

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Closing Special Interest Government

The federal government was originally conceived as an institution with limited, enumerated powers. However, over time interest groups and politicians cooperated in vastly expanding federal powers. Indeed, Congress has routinely conferred political status upon influential interest groups, such as labor, by creating their own cabinet departments.

The Bureau of Labor was established in 1884, from which sprung the Department of Commerce and Labor in 1903, only to split into two separate departments in 1913. Today the Department of Labor runs a national unemployment insurance system, regulates employment hours and wages, offers a hand to unions under the guise of monitoring employee-employer negotiation, conducts training programs, and generally oversees the workplace.

It should come as no surprise that organized labor has sought a formal beachhead in government. After all, business enjoys manifold subsidies from the Department of Commerce, whose primary function is to enhance corporate profits. But even many private firms today see the federal government as a kind of negotiator-in-chief when it comes to other companies' labor disputes. During the United Parcel Service strike, *the Chamber of Commerce* called on President Clinton to order the workers back to work and the company back to the negotiating table. Although the President declined to do so, he did pressure the parties to reach an agreement. Moreover, he, like his predecessors, had no principled objection to using his power, having ended the earlier strike against American Airlines as it began.

Here, as elsewhere, government has metastasized beyond any conceivably appropriate role. Labor relations are a private matter. Government should act only as impartial arbiter, preventing either side from using violence to achieve its ends and providing the framework for adjudicating disputes—are both sides living up to their contract? But questions as to whether workers join or are represented by a union, and what terms employees and employers agree on, should not be answered by government.

Of course, the Labor Department was not created out of a principled desire to solve problems. Rather, it was essentially a payoff to labor unions. The bias was most evident during the New Deal, though many of those laws live on. Losers are not just companies faced with government-backed unions, but workers who don't want to support a union. Individual choice has never been seen as a virtue by government.

The Labor Department has not limited itself to regulating employment relations. It grabbed a growing piece of the welfare state when Washington's crusades like the War on Poverty created new government programs hither and yon. Although the old Health, Education, and Welfare picked up the majority of welfare programs, Labor got ahold of

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a host of employment-related initiatives, ranging from job training to voluntarism.

It is perhaps here that Congress should start. The agency's training programs have, in the main, proved to be abject failures. Scores of government efforts have had only minimal success in providing workers with more remunerative and permanent work. And that should come as no surprise, since government has no incentive to narrowly tailor public initiatives to individual needs. Congress should leave training to workers and employers.

Unemployment insurance discourages not only work, but also private savings to cushion a period of joblessness. Congress should abolish the program or, as second best, leave it with the states. One of the virtues of federalism is allowing different communities to handle problems like unemployment differently.

Congress should also roll back federal regulation of the labor market. The minimum wage destroys jobs, since it prices out of work anyone who lacks sufficient education, experience, and skills to earn the minimum. Were this not the case, the government could make everyone rich by imposing a minimum of $100 or $1,000 an hour. Similar in effect is the Davis-Bacon Act, which requires the payment of union-scale wages for federally funded construction projects.

Restrictions on overtime and other work conditions are equally misguided. Employees and employers should be free to bargain over the terms of their employment. Different workers are likely to prefer different packages of benefits; there is no reason for Washington to decide, say, the overtime pay rate, or under what circumstances companies can instead offer comp time.

Similarly, the government should not be in the business of promoting labor unions or aiding corporations. Early in its history Washington favored the latter; more recently it has leaned towards the former. But, again, federal regulation, though justified as helping working people, actually interferes with the right of employees to choose the employment conditions they prefer. At the same time, restrictive regulations bar workplace flexibility—which benefits employees and employers alike—and penalizes blameless companies for transgressing rules designed to give organized labor an unfair boost in representation elections. Congress should, among many other things, end exclusive representation by one union, restrictions on labor-management cooperation, and the requirement that firms hire union organizers as employees.

Especially important is statutory enforcement of the 1988 U.S. Supreme Court decision, *Communications Workers of America v. Beck*, which grants workers the right to a refund of any union dues used for political purposes. One of the first acts of the Clinton administration was to repeal federal rules requiring that unions give an accounting to their members. As a result, most labor unions today flout the law, collecting dues with the implicit aid of the federal government for use in partisan political campaigns.

Congress should also dismantle the Occupational Safety and Health Administration (OSHA). Despite imposing annual costs estimated to run between $11 billion and $34 billion on the economy (the agency's nitpicking regulation is legendary), there is no evidence that OSHA has improved U.S. workplace safety. The rate of employee fatalities has been falling for six decades, and is affected more by insurance requirements and tort litigation than by OSHA. (After all, it is not good business for companies to end up with dead workers.) At the same time, there has been little drop in workplace injuries since the creation of OSHA. The most realistic assessment of the maximum benefit of OSHA regulation is about $4 billion, which falls somewhere between one-third and one-ninth of the cost imposed by the agency on the U.S. economy. Repeal, not reform, is warranted, leaving workplace safety constrained by a variety of more cost-effective mechanisms, including private lawsuits and market pressure.

Such tasks as collecting statistics and figuring the rate of inflation (Bureau of Labor Statistics), could be transferred to the Census Bureau. Oversight of private pensions (Pension Benefit Guarantee Corporation) could be shifted to the Treasury Department, with

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the agency stripped of its role as guarantor—which poses multibillion dollar liabilities for taxpayers—and focused instead on ensuring that private companies fulfill their contracts to former employees.

The federal government has grown dramatically and inexorably because politicians desiring to expand their power have joined with interest groups desiring to benefit from that expansion of political power. The Labor Department is an example of a government bureaucracy that should not exist: a wasteful amalgam of special-interest subsidies and officious government interference. This would be a good place for Congress to begin paring government back to its essentials. □

TV Taxes

by Raymond J. Keating

Christmas arrived early for TV broadcasters this year. Way back in March the federal government played Santa Claus.

Over a four-day period, from March 31 to April 3, Washington gave away the proverbial store to the nation's over-the-air television broadcasters. A major step by the Federal Communications Commission (FCC)—taken per a Democratic White House and Republican Congress—and a decision by the U.S. Supreme Court will both prove quite costly for taxpayers, consumers, and the U.S. Constitution. It is corporate welfare run amok.

Broadcasters were handed tens of billions of dollars worth of broadcast spectrum, free of charge.

Earlier this century, the government asserted the right to manage the spectrum, the airwaves over which television, radio, and other forms of communication are transmitted. This year the federal government flexed its industrial-policy muscles, decreeing that American consumers should watch digital-quality television (with its purported better picture and sound) whether they want to or not. Broadcast television stations will use their new, free-of-charge channels to send out digital signals of their commercial TV service, currently delivered through less efficient analog signals; some frequencies will be left for subscriber-paid services. Broadcasters will simultaneously send out their analog and digital signals for about the next decade, after which the old signal will end, with that section of the spectrum supposedly returned to the government for auction.

In effect then, over the coming decade the broadcasters, backed by the federal government, will push consumers to buy new digital TV sets or set-top converters for their old TVs. This amounts to a TV tax on consumers, potentially running into hundreds of dollars for converters and thousands of dollars for digital televisions. At the same time, were the spectrum auctioned off, rather than given away, billions of dollars in revenues could be collected and used to retire a bit of the federal government's outstanding debt. Indeed, at this point Washington's lone goal should be to extract itself from any involvement in the broadcast spectrum—but for safeguarding property rights—and the best means to do so would be to auction off the entire spectrum, allowing the marketplace, not government, to decide the future of over-the-air telecommunications.

Mr. Keating serves as chief economist for the Small Business Survival Foundation and is the author of New York by the Numbers: State and City in Perpetual Crisis *(Madison Books).*

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As for the promise by broadcasters to eventually return their old spectrum, don't hold your breath. If consumers resist paying the TV tax and stay with their old televisions, the broadcasters could keep all of their spectrum for some time. Either way, it's a lose-lose proposition for taxpayers.

The Must-Carry Rule

Meanwhile, also in March, the Supreme Court struck another blow for industrial policy and the TV broadcasters by upholding a 1992 federal law mandating that cable television systems carry local broadcast stations, i.e., the must-carry rule. In the continuing, perverse "tradition" of judicial activism, the Court utilized, as Justice Sandra Day O'Connor put it in her dissent, "a highly dubious economic theory" to uphold the law. The economic viability of local broadcast stations was considered as an issue by the Court, while the First Amendment (i.e., free speech) and the Fifth Amendment (i.e., takings) were discounted.

In the case of must-carry, the federal government has decided that a local broadcast station must be seen by cable TV subscribers over other stations such as C-Span and ESPN. Of course, this law violates private-property rights, interferes with the superior workings of the free market, and overrides what consumers may actually demand.

Government should neither be guiding the development of television technologies, nor ensuring the economic viability of local broadcasters. If only we could click off government officials, who insist upon ignoring the free market and the U.S. Constitution, as easily as we turn off the often moronic television shows the broadcasters offer over the airwaves. □

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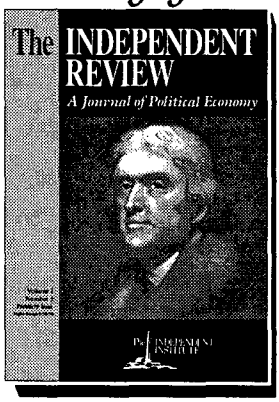

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THE FREEMAN
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How Fair Is "Fair Housing"?

by George C. Leef

Owning property used to mean that you had the right to do with it as you pleased. You could sell it, rent it, or give it away. You could also refuse to do so. Some people might be disappointed by your decision, but all they could do was to search elsewhere for what they wanted. There was no legal recourse for having been told "No."

But now there is. Thanks to federal and state "housing discrimination" statutes, would-be purchasers and renters can collect damages if they can show that the owner "discriminated" against them, which means they were told "no" without what the government regards as a good enough reason. The government now casts a long and ominous shadow over the housing market. It is one more slash in the death of a thousand cuts being administered to property rights in America. Just ask John Hoffius.

Hoffius owns several apartments in Jackson, Michigan. He was approached by an unmarried couple who wanted to rent one of his units. He declined to do so on religious grounds, stating that he believed it was wrong for a couple to live together out of wedlock. He couldn't stop them from cohabiting, but he could prevent them from doing so on his property. So he thought.

The couple filed suit, seeking damages of $10,000 each. Of course, they were not really harmed. John Hoffius took nothing of theirs. Their only damage was having devoted a small amount of time to applying for his apartment. Nevertheless, the misnamed American Civil Liberties Union and a bevy of "fair housing" groups joined in.

So far, two courts have ruled in favor of Hoffius, but the case is now on appeal to the Michigan Supreme Court. Even if he ultimately prevails, he will have lost, since defending the suit has cost him thousands of unrecoverable dollars. (The law allows the plaintiff to recover attorneys' fees if he wins, but not the defendant.) But Hoffius has been fortunate. In California, Evelyn Smith lost a similar case when the California Supreme Court decided that forcing landlords to rent to unmarried couples did not put a "substantial burden" on landlords' religious freedom.

Many housing "discrimination" cases are brought (or threatened) each year. Often, they are instigated by organizations like the Fair Housing Center of Metropolitan Detroit (FHCMD). The budget for FHCMD comes largely from the federal government, augmented by some private donations. It advertises for individuals who have "suffered discrimination" and, after learning about their experiences, usually sends in "testers." If "discrimination" is found, then an FHCMD attorney contacts the owner to say that they will file suit unless the owner settles.

In the case of *Darby v. Heather Ridge Apartments*, the plaintiffs alleged racial discrimination. The Darbys, a black couple, sought to rent an apartment, but were informed that no units would be available for more than a month. However, white appli-

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cants were told that there were units immediately available. The plaintiffs sued and won $450,000 in damages.

Racial discrimination like this is both immoral and irrational. However, just because an act is immoral and irrational doesn't mean anyone has been directly harmed (in contrast to more nebulous emotional hurt). Except for the loss of some time, the Darbys were no worse off than if they had never stopped at Heather Ridge. But they hit the jackpot with a jury that "wanted to send a message."

Lawsuits Abound

That the law is simply viewed as a tool for enrichment is evident from *Lawson v. Paragon Properties*, in which a black couple applied for apartments at two different complexes. Within days, they had been accepted at one, but the other took three weeks to reject their application. Rather than simply move in where they'd been accepted, the Lawsons filed suit against the other complex and wound up with an award of $17,500. In cases like this, the law seduces people into needless, wasteful litigation.

Another fount of lawsuits is the legal obligation not to discriminate against people who have "disabilities" and need "accommodation" in housing. In *Herzberg v. Plymouth Heritage Apartments*, Cindy Herzberg sought to rent an apartment. But she needed an access ramp to the unit for her wheelchair. The owner said Ms. Herzberg would have to pay for the ramp, which would cost some $1,700. Herzberg cried "discrimination!" and the case wound up before a mediation panel that decided it was unreasonable of the owner not to want to spend $1,700 in constructing the ramp. The mediators tacked on an extra $10,000 in damages to teach the owner to be more sensitive.

Sometimes advertising provides the excuse to sue. In 1996, FHCMD won an arbitration award of $569,000 against the owners of Henry Ford Village in Dearborn. For more than two years, FHCMD had monitored the advertising of the Village. Among hundreds of ads, only one showed any nonwhite people. There was no evidence the complex treated whites and blacks differently, only that its advertising seemed to convey a preference for whites. The arbitrator ordered the company to shell out $469,000 over the next three years to hire a "manager of affirmative marketing," retain a consulting firm to help devise an "affirmative marketing plan," include an "Equal Housing" logo in all advertising, and pay FHCMD $100,000.

One can have sympathy for the objectives of groups like FHCMD even while abhorring their methods. Housing discrimination is offensive, but it is a rare phenomenon simply because it usually proves costly to the one practicing it. If a landlord has a vacant apartment and turns away decent, paying tenants because of something he doesn't like about them, he loses revenue. There are nearly always others in the marketplace who are happy to rent to those who were rejected. "Fair housing" centers would perform a more valuable service if they assisted people who encountered discrimination to bypass it, by finding places where they would likely be accepted.

Unfortunately, however, discrimination suits hold out the prospect of great windfalls for plaintiffs, attorneys, and "fair housing" centers. Why do something peaceful but not very profitable when you can use the law to shake down property owners?

Persuasion, Not Force

Housing activists might respond that only the threat of lawsuits will change attitudes. Possibly so, although persuasion and positive incentives are usually more effective than force. In any case, an important part of freedom is tolerating those who do not share our values and beliefs. People have no more a right to use force to make people have the "right" attitude toward prospective tenants than to make people have the "right" attitude toward the Social Security System, opera, or immigration.

Instead, those committed to "fair housing" should use noncoercive means to accomplish their ends. If, for example, they have evidence that a landlord discriminates in ways they

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deem to be inappropriate, they could publicize this fact and organize a boycott. But doing so requires persuading other people to cooperate with you, and that is more difficult than convincing a few jurors to indulge in vicarious generosity. Moreover, those adamantly opposed to any kind of housing discrimination could cooperate to buy "bad" landlords out of not only their property, but the business entirely. If activists aren't willing to put up their own money to achieve their objective, why should they be allowed to take the easy route of a lawsuit?

Like so many other pieces of statist legislation, the "fair housing" laws are misnamed. There is nothing fair about coercing people who have simply decided to contract in ways that some other people find objectionable. If all "fair housing" statutes were repealed, then housing activists would have to use their own time and money to assist those for whom they express so much concern. □

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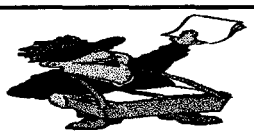
***The Link* - INDEX - Vol. 3, Issue 1**

A Schoolteacher's Intuition	by John Taylor Gatto	Page 4
Editorial Page	by Mary Leppert	Page 5
The Link Reviews	by *The Link* Staff	Page 6
Marvelous Math	by Alice Rohan	Page 7
Accreditation of ISPs	by Jackie Orsi	Page 8
Homeschool Climate Change	by Marilyn Mosley	Page 10
Weighin' In (Legal News & Sundry)		Page 12
Great Document Series		Page 14
Foreign Language	by Donna Fasuros	Page 17
Drawing With *Visual Manna*	by Sharon Jeffus	Page 20
Lennon's Room - A Place for Kids	by Lennon Leppert	Page 25
Sound Words & Others	by Gary Grammar	Page 27
Millennium Moments	by Arielle Gorin	Page 28
The Colfax Corner	by The Colfaxes	Page 33



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THE FREEMAN
IDEAS ON LIBERTY

Technology and the Work Force: Work Will Not End

by Donald K. Jonas

In his recent provocative book *The End of Work*, Jeremy Rifkin joins a growing chorus of social pessimists who argue that advanced technology leads to a concentration of wealth in the hands of "the elites" followed by wholesale unemployment for the masses. Some critics contend that if we continue our pattern of adapting technological advances to the work force, in the very near future all work will literally end.

In fact, these techno-pessimists are wrong. Rather than ending, work is evolving. New technologies are changing the skill requirements of workers, not making workers obsolete.

The technocratic straw man constructed by these critics of the absorption of technology is comical in its simplicity. Technology does not, in and of itself, destroy jobs. Nonetheless, we are inundated with heartbreaking stories of individuals pushed out of the job market, usually by ruthless corporate villains intent on using advanced technologies to cut jobs.

One such indictment was Donald Barlett's and James Steele's "America: Who Stole the Dream?", which ran in newspapers across America during the late summer of 1996. The ten-part series relied on anecdotal stories of technologically displaced workers. In virtually every case, Barlett and Steele used a downsized worker to "prove" their unsubstantiated rule. These stories of personal tragedy echo the events of a century ago as Americans left the farm for the factory. At that time, William Jennings Bryan, the Democrats' nominee for President in 1896, cried, "Burn down your cities and leave our farms, and your cities will spring up again as if by magic, but destroy our farms, and the grass will grow in the streets of every city in the country." Populists tried in vain to hold on to the agrarian lifestyle by resisting the relentless march of industrialization.

Their attempt failed miserably. Whereas in 1790 farmers comprised 90 percent of our population, by 1900 they accounted for just 38 percent; today, just over two percent of Americans are farmers. But this decline did not represent an "end to work," and grass does not now grow in our city streets. Although many farmers have felt the pain of job loss, the new opportunities presented by the growing industrial age amply compensated for these short-term dislocations. Today one sees striking parallels between the dislocated farmer at the turn of the twentieth century and the laid-off industrial worker at the dawn of the 21st century. Both cases involve immediate but short-term discomfort for many in the work force while the displaced workers adapt to the new and more profitable opportunities made available by technological change.

Numerous social theorists have tried to describe this social change, calling it a "post-industrial age," an "information age," and

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even a "postmodern era." In today's society knowledge and the ability to process information have become central to one's economic success. Workers who do not measure up to this standard can experience significant anxiety and pains. Nevertheless, the evidence soundly contradicts the apocalyptic ramblings of Rifkin and his associates who fear that advanced technologies will destroy all jobs.

As these writers spread their fatalistic vision of America's future work opportunities, one should note that we've been hearing this refrain repeatedly for hundreds of years. "Technology" (along with its partner in crime, "globalization") gets blamed for destroying the labor market. But as Perry Pascarella has argued, "Technology is created by humans to assist us in our work . . . technology makes no promises of improving our lives. But it does give us the economic power to improve our lives in economic dimensions."

Throughout the course of history new technologies have been introduced to the economy that drastically change how we work. Consider these brief examples, cited by Michael Rothschild in *Bionomics*:

- Gutenberg's movable type press in 1440 is often hailed for democratizing information and spreading religion to the masses. From a techno-pessimist viewpoint, however, Gutenberg's invention was hell on the scribe business, reducing it by 98 percent in a few short years. But this technological advancement opened up previously undreamed-of opportunities for work.
- The invention of the "power loom" in Britain in the early 1800s allowed steam-driven machines to mass-produce cloth. The hand-loom operators displaced by this new technology, fearful for their livelihood, attempted to stop technological progress by destroying these new machines. The Luddites, as they became known, would have prevented the labor-saving power loom from improving the efficiency of British cloth manufacturing, increasing production, lowering prices, and opening up new markets.
- The internal combustion engine, while creating thousands of new jobs in the nascent automobile industry at the beginning of the twentieth century, wreaked havoc on the carriage-making industry: between 1909 and 1919, carriage-making employment fell from 70,000 to 26,000. Employment in the new automobile industry, however, soared from 85,000 to 394,000, far outstripping the job losses in the displaced carriage industry.
- Employment in the telegraph industry peaked at 87,000 workers in 1929 and then declined to a mere 24,000 workers by 1970. Did those jobs just disappear? Glance over to the telephone industry, which by 1970 had created 536,000 new jobs.

It is useful to probe a bit deeper into the thoughts of the modern technological pessimists. Consider:

1. Hype: Jeremy Rifkin claims that "The ranks of the unemployed and underemployed are growing daily in North America."

Reality: It is simply untrue that unemployment is rising in America. Alan Reynolds reports that unemployment due to job loss is very near a record low, approximately 2.5 percent, and is as low as it was at the peak of past cycles in 1979 and 1989. The overall unemployment rate remains very low and in recent years the U.S. economy has created more jobs than it has displaced. Since 1991 the U.S. economy has lost 14 million jobs and created 15.5 million new ones.

2. Hype: Rifkin also contends that "While some new jobs are being created in the U.S. economy, they are in the low-paying sectors and generally temporary employment."

Reality: During recent years most service-sector job growth has occurred in higher-paying managerial and professional-specialty jobs. Further, according to the Bureau of Labor Statistics (BLS), most of the net growth (68 percent) in full-time jobs between February 1994 and February 1996 occurred in job categories paying above the median wage. Most of these jobs were in occupations in the top third of wage levels.

3. Hype: Peter Cappelli in his 1997 book *Change at Work* argues that "It has been very difficult for displaced workers to find new jobs since the mid-1980s."

Reality: According to recent statistics,

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most displaced workers who lose their jobs quickly end up making more money than before. An August 1996 Federal Reserve survey found that fired executives and managers were finding jobs with the same or better salaries in an average of 2.8 months in 1996, down from 3.2 to 3.3 months in past years.

4. Hype: Donald Barlett and James Steele contend that after the American worker, the "biggest loser has been the small business owner. Unlike multinational corporations that have closed factories and shifted production abroad to take advantage of cheap labor, small companies seldom have that option. These businesses are being squeezed out."

Reality: Small businesses are a major source of employment in America's information-age economy. The Small Business Administration notes that businesses with fewer than 500 employees represent 54 percent of all American jobs. Small business firms today account for more than 70 percent of all job growth in the American economy. Cognetics, a Massachusetts market research firm, estimates that there are roughly 300,000 U.S. companies with fewer than 50 employees that are growing at better than 20 percent per year.

5. Hype: Rifkin says that "The fact is that while less than one percent of all U.S. companies employ 500 or more workers, these big firms still employed more than 41 percent of all the workers in the private sector at the end of the last decade. And it is these corporate giants that are re-engineering their operations and letting go a record number of employees."

Reality: Despite the highly publicized layoffs by large companies such as AT&T, big firms in general are not firing as many employees as many critics think. A recent survey by the American Management Association (AMA) found that although two-thirds of 1,003 major companies surveyed in 1995 had gone through at least one work force reduction since 1989, two-thirds of these 1,003 firms employed as many or more workers in June 1995 as in January 1990.

6. Hype: Rifkin argues that "Men and women who just a few short years ago were taking home wages in excess of $30,000 consider themselves lucky to find jobs as janitors or security guards for $5 an hour. For them and their families, the post-World War II dream of being part of the middle class is over."

Reality: Citing the University of Michigan's Panel Survey on Income Dynamics (which has tracked the individual earnings of over 50,000 Americans since the late 1960s), Federal Reserve Bank of Dallas economist W. Michael Cox finds that wages for America's workers are actually rising. Cox notes that only five percent of those who started out in the lowest income bracket in 1975 remained in this bottom tier by 1991. Furthermore, approximately four out of every five Americans in this lowest bracket had made it into the middle class, and 30 percent of these individuals vaulted into the highest income bracket by the early 1990s.

It is true that earnings for those with at most a high-school diploma have fallen, which suggests that low-skilled people face tremendous challenges that will become even more daunting. But the techno-pessimist interpretation of the economic statistics is one-sided. The terrifying claim that computers are eliminating jobs is simply not supported by the evidence.

The typical pessimistic analysis argues that American workers are being permanently left behind as businesses automate production facilities through the introduction of advanced computers and other sophisticated technological tools. As computers become more integrated into the American work force, the argument goes, workers will become less necessary.

It is too early to argue such a point, however, especially in light of history. A major, transforming tool like the computer may take years to become fully integrated into the economy. Paul David of the Center for Economic Policy Research at Stanford University figures that it took more than 50 years to fully assimilate the shift from steam to electromechanical technology, which began almost a century ago. Some of the most

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beneficial impacts of electromechanical technology, especially in terms of increased work opportunities, did not arise until nearly two-thirds of the way through the transition. Workers acted on their incentive to retrain for jobs in the newly altered economy, just as they had done during previous economic revolutions. Similarly, today's computer revolution is restructuring, not destroying, the work force.

Of course, these pessimists believe that, even with massive retraining and re-education, there will not be enough high-tech jobs to go around. But Perry Pascarella argues that pessimism is "an easy game to play" because technological disaster always seems to be just around the corner. Social critics have forever warned of a coming technological catastrophe, be it a nuclear mishap, an environmental disaster, or some other cataclysmic event. But we're still here.

Admittedly, not all is rosy for America's short- and long-term economic future. Existing government policies currently pose a barrier to the market process of "creative destruction" that will create new work opportunities in the new economy. There are many wide-ranging proposals, from regulatory reform to competitive educational changes, that we should seriously consider as we exit the industrial age in order to raise America's growth rate above its currently sluggish levels.

We live in a rapidly changing, globally competitive technological marketplace. Society is in the midst of a major transformation away from the industrial age into the information age. There is real value in peeking into the future. But the technological pessimists are using glasses that are too intellectually biased to yield results that even approach practical reality. Although nothing is certain, one prediction is likely to come true: work has not ended. □

Business and Morality in a Free Society

by Edward W. Younkins

Few would deny that capitalism is the most productive and efficient economic system, especially after the collapse of Soviet Communism. But some critics still contend that capitalism is not a moral system.

Yet morality is impossible unless one is free to choose between alternatives without outside coercion. Since capitalism is based on freedom of choice, it provides the best environment for morality and character development. In addition, business success not only requires but also rewards virtuous behavior by participants in the market.

Dr. Younkins is professor of accountancy and business administration at Wheeling Jesuit University, Wheeling, West Virginia.

Morality Requires Freedom

All human beings have natural rights either endowed by their Creator or inherent in their nature, and have a moral obligation to respect the rights of others. Natural rights impose the negative obligation not to interfere with someone else's liberty. Thus, it is morally illegitimate to use coercion against someone

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who does not first undertake the use of force. The role of government, as recognized by America's founders, is to protect man's natural rights.

This kind of freedom involves far more than simple democracy. It demands a protected private sphere within which an individual can pursue his freely chosen norms, actions, and ends without the arbitrary intervention of others. And this freedom is necessary for individual morality.

There can be no morality without responsibility and no responsibility without self-determination. Responsible self-determination implies rationality, honesty, self-control, productiveness, and perseverance. In order to provide the maximum self-determination for each individual, the state should be limited to maintaining justice and defending against internal or external coercion, thus protecting life, liberty, and property.

A social system such as capitalism is a system of relationships and cannot be moral or immoral in the sense that a person can be—only individuals can be moral agents. However, a social system can be moral in its effects if it promotes the possibility and likelihood of moral behavior by individuals who act within it. It follows, then, that there is a moral imperative to create a political and economic system that permits the greatest possibility for self-determination and moral agency. Capitalism is that system.

Capitalism is itself only a means and requires its individual participants to decide on the ends to be pursued. No economic system can make people good. The best that an economic system can do is to allow people to be good. But morality and virtue require that individuals be free to be immoral and of bad character. Only when an individual has choice and bears responsibility for his actions can he be moral. Capitalism, more than other economic systems, allows the exercise of individual free will. Thus, though capitalism cannot guarantee a moral society, it is necessary for one.

Human development usually requires more than material wealth. However, prosperity enables individuals to cultivate their talents, abilities, and virtues. Thus, capitalism, the best system for wealth creation, permits individuals to spend less time on physical concerns, leaving them more time to engage in higher pursuits.

The Moral Responsibility of Businessmen

At the same time, the achievement of prosperity tends to reward moral behavior. Businesses—more particularly, their owners, managers, and other employees—have moral obligations. They must respect the natural rights of other individuals, which includes honoring contracts, not engaging in fraud, not using coercion against others, and honoring representations made to the local community. Moreover, businessmen should not support government economic interventions, such as price supports, tariffs, and subsidies, even though doing so might result in higher profits. To do so would involve the use of coercion, one step removed.

Living up to these virtues will aid businessmen in the pursuit of profit. The free market rewards polite, cooperative, tolerant, open, honest, realistic, trustworthy, discerning, creative, fair businessmen. Lying to and cheating other businesses, misleading consumers, and mistreating workers all have serious adverse consequences. In the long run, profitable businesses tend to be operated in accordance with the basic ethical principles most people hold dear.

Under capitalism a business transaction takes place by mutual agreement for perceived mutual advantage. Through voluntary exchange buyers and sellers can promote their own interests only by serving the interests of others. By protecting individual choice, capitalism not only generates enormous wealth, but also creates an environment in which virtue can flourish. In the end, capitalism is not only the most productive and efficient economic system. It is also the most moral economic system. □

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Juvenile Delinquency

Government brings out the kid in all of us. This truth is key to political understanding.

Nanny-state activities are government's best-known way of babying its citizens. States insist that drivers buckle up; the Clinton administration never tires of scolding cigarette smokers and tobacco companies; Congress now dictates the amount of time that women must remain in the hospital after giving birth, as well as the amount of water that we free citizens are allowed to have in our toilet tanks; and the Americans With Disabilities Act hovers over us like a diabolic schoolmarm made paranoid by the mistaken belief that her charges act with no purpose in life other than to commit malicious injustices to the handicapped. These are only a few of the tens of thousands of instances of how our nanny state abuses and insults us.

But the nanny state's frightfulness doesn't end with these particular abuses and insults. Its pernicious effects run much deeper. In particular, the more we relinquish decision-making responsibility to government, the more childlike we become.

Consider the response of a New Jersey woman to my suggestion that New Jersey's prohibition on self-service gasoline stations be lifted. "Oh, no!" cried the woman, "that would be disastrous! People here don't know how to pump their own gasoline. They'd spill it all over the place!"

As it happens, my wife hails from New Jersey. Until she moved to Virginia at the age of 26, she had never before filled her own gasoline tank. Sure enough, the first time she tried to gas up at a self-service pump in Virginia, she squeezed the pump handle before inserting it into her gasoline tank. The result was quite a mess—and, with fresh gasoline sprayed all about until the shop attendant washed it away, also quite dangerous.

My wife (who now regularly, and expertly, refuels her car herself) learned how to pump gasoline the hard way. Had she grown up in a state that trusted its citizens to pump their own gasoline, she would never have squeezed the pump handle before popping it into her tank. New Jersey's prohibition on self-service gasoline stations prevents people from gaining useful experience. In its own (thankfully small) way, this prohibition keeps people from fully growing up.

While the nanny state stunts personal growth, the political process encourages childlike behavior in a less obvious and more pernicious way. A mark of immaturi-

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ty is the inability or unwillingness to make sound decisions—failure to weigh carefully the present and future benefits and costs of available alternatives. Because children cannot be trusted to make sound decisions, adults don't give them much decision-making responsibility.

Why don't parents let eight-year-olds decide how to spend the family income? Because with eight-year-olds in charge, the family would vacation for months on end at Disney World—and be broke in short order. When spending their parents' money, eight-year-olds ignore the costs and long-run consequences of extended stays with Mickey Mouse, focusing only on the immediate thrills of such vacations. People who consistently act in ignorance of long-run consequences are rightly called "childish."

By this criterion most voters behave childishly. Citizens in the voting booth help decide a multitude of important issues. Should Congress increase subsidies to farmers? Should the federal government fund high-tech research? Should the state government pay for a fancy domed stadium to attract an NFL franchise? The idea of democracy is that citizens, by voting, collectively make such decisions.

But citizens have no incentives to make mature decisions in the voting booth.

First, voters are typically asked to decide how to spend other people's money. Just as children have no trouble spending mom and dad's money, voters have no trouble voting for pet projects to be financed largely by others.

Second, no single vote counts; no single vote decides the outcome of an election. So, no matter how a voter votes—no matter how absurd, unrealistic, or destructive a voter's wish may prove to be—the fact that no single vote counts means that no single voter incurs any material cost of voting in whatever way strikes his fancy.

Imagine a child on the knee of a shopping-mall Santa. Because it costs the child nothing to request truckloads of playthings, the child asks for everything that pops into his mind, giving no thought to costs or harmful side effects. But because Santa forgets each child's request as soon as the child leaves, the child on Santa's knee is in a harmless fantasyland.

But suppose that all the shopping-mall Santas tallied up the wishes of all the kiddies and then tried to make these wishes come true. Society would be awash in toys, desperately short on many of life's necessities, and drowning in debt!

Citizens in a voting booth are much like children on Senator Santa's knee. Enter the voting booth and vote for the candidates promising the greatest amount of wizardry! Because your vote is not decisive, you suffer no personal repercussions in the voting booth of using your ballot to express all sorts of fantasies. Of course, every other voter is in an identical position.

Thus, democratic elections encourage voters to behave irresponsibly in the voting booth, just as sitting on Santa's knee encourages little children to rattle off long wish lists of toys. But unlike shopping-mall Santas, voting booths tally up voters' dream-world requests and pass these requests onto government. Politicians try in vain to satisfy these unsatisfiable requests.

Compare democratic voting with private decision-making. Perhaps a car buyer dreams of owning a car that gets 100 mpg, packs herds of horsepower, and is safe as a tank. Automakers will supply such cars to buyers willing to pay the price. But because such cars must be paid for by each individual buyer, no buyer indulges these costly fantasies. Each buyer settles for a less fanciful car because each buyer prefers to save the extra money it would cost to buy the fantasy automobile.

Such rational weighing of costs and benefits is the mark of maturity. Pathetically, democratic voting encourages too many otherwise mature adults to behave like spoiled brats propped on Santa's knee.

Donald J. Boudreaux
President

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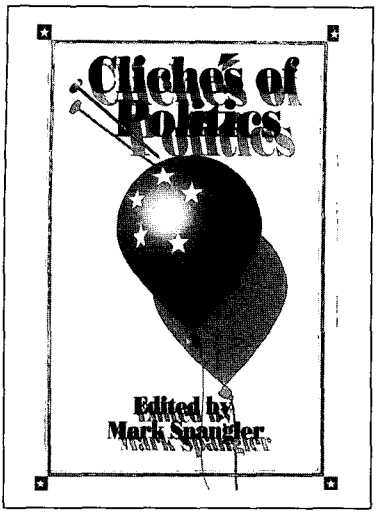

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THE FREEMAN
IDEAS ON LIBERTY

The Minimum Wage

by Kevin Sohr and Walter Block

The second stage of the minimum-wage increase approved by Congress last year recently took effect. What will the impact be on the economy and particularly on unskilled workers? Economists have long argued that minimum wage increases cut employment, particularly of minorities and teenagers. But supporters of the minimum wage, now backed by some economists, claim that government-legislated wage hikes do not necessarily lead to less employment, and may even create more jobs for the unskilled. So does the minimum wage benefit or injure workers?

Traditionally economists have maintained that the free market establishes the wages for all workers so that they receive the value of their output. If Sam is earning $2 an hour while generating $2.50 worth of goods and services for Firm X, then Firm Y would have an incentive to offer Sam $2.01 per hour. Firm X would then counter with $2.02 and the cycle would continue until Sam was paid $2.50 an hour. No firm would bid higher because he was simply not worth it. What happens when the minimum wage is set by law at $3.00? According to classical economists, Sam will lose his job.

But David Card (now at the University of California, Berkeley) and Alan Krueger of Princeton University have challenged the traditional model. In 1992 New Jersey increased its minimum wage while neighboring Pennsylvania held its rate constant. In a study published in 1994 Card and Krueger concluded that employment in New Jersey's fast-food industry actually rose after the wage hike. In contrast, industry employment fell in Pennsylvania. How can this be? The Card-Krueger study leads us to believe that employers demand more labor as its price rises. Such counterintuitive findings require a deeper look.

The Card-Krueger model's method of data gathering has been widely questioned. Via phone surveys, the team interviewed managers from 321 fast-food franchises in New Jersey and 78 in Pennsylvania. This is a very small number of firms to use as evidence for such significant findings. Also, the information given by stores may not be accurate. Burger King managers are not statisticians or even bookkeepers; the study should have employed repeat interviews by a second set of researchers.

Moreover, while the law went into effect on April 1, 1992, the interviews regarding the impact of the legislation were conducted between November 5 and December 31 of that year. By using such a limited window, just seven to nine months after the implementation of the law, Card and Krueger did not give the market sufficient time to develop alternatives, such as automation, to low-skilled labor. (Had they conducted interviews on April 1, their results would have shown zero impact.) Milton Friedman rightly argues that "It takes time for firms . . . to shift to ways of doing things which place less reliance on unskilled labor."

Mr. Sohr is a student, and Dr. Block a former professor, at the College of the Holy Cross in Worcester, Massachusetts. Dr. Block is now chair of the department of economics and finance at the University of Central Arkansas.

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Yet another possible fault with their findings is the actual significance of the minimum-wage increase. At the time of the hike, two-thirds of the restaurants were already paying more than the minimum. In these cases the market had already provided lower-skilled workers with high wages.

Moreover, even if employment did increase in the fast-food industry when the minimum wage rose, this result is still not necessarily good for society. Economists David Neumark and William Wascher have found that an increased minimum wage will decrease the number of teens enrolled in high school and raise the proportion who are unemployed. Why this paradoxical result? The higher minimum encourages more skilled teens to drop out, while making it more likely that those who were already working will lose their jobs.

The dramatic conclusions of the Card-Krueger project contrast sharply with its poor quality. Observes economist Robert Barro: "An annoying feature of the Card-Krueger research is their eagerness to use their findings to discredit the law of demand. . . . It shows extraordinary arrogance to use tenuous empirical evidence . . . to proclaim the first documented case in which demand curves fail to slope down. A more reasonable view is that the demand curve is just fine, and the Card-Krueger empirical analysis needs repairs."

Moreover, the minimum wage is not an equal opportunity destroyer. Teens in general suffer more from this law than do adults. Each succeeding increase in the minimum wage has negatively impacted teenage unemployment rates. Just as the minimum wage attacks the young more than the old, it also harms blacks more than whites. Observed Milton Friedman more than three decades ago: "Of all the laws on the statute books of this country, I believe the minimum wage law probably does the Negroes the most harm." Each increase in the minimum wage has been followed by an immediate widening of the unemployment rate gap between black and white teens. Prior to the 1949 increase the two rates were virtually identical; immediately a gap was created. Every subsequent increase led to a dramatic increase in non-white unemployment while the white level stayed relatively stable.

The problem is not racism, but lack of employment skills. Friedman explained that black "youngsters are less productive than white youngsters. They tend to have a lower level of education, a lower level of skill." This being the case, any given level of mandated wage is likely to trap more black than white youth.

The one advantage low-skilled workers might have over their skilled counterparts is price competition, offering to work for less. But the minimum wage makes such an offer illegal. Thus, the minimum wage hurts those whom it is intended to most help: unskilled laborers.

Given its disastrous consequences, why does the minimum receive so much support? It preys on people's good intentions. Voters think: Poor people are not making much money. How can we help them? Mandate that their bosses pay more. When a politician opposes an increase, people hear "I want poor people to earn less money."

The minimum wage keeps rising. The impact will continue to be to hurt poor, young, black, and unskilled workers. Despite the highly publicized study by Card and Krueger, the economic evidence overwhelmingly indicates that the minimum wage destroys jobs. □

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THE FREEMAN
IDEAS ON LIBERTY

Loved to Death: America's Unresolved Health-Care Crisis

by Michael J. Hurd

The Canadian health-care system of single-payer, socialized insurance is in trouble. Yet Congress and the president continue to push the American system in the same direction.

As Canada's national government slashes spending on medical care in order to reduce the deficit, local provinces are reducing medical staff. In Ontario, pregnant women are being sent to Detroit because no obstetricians are available. Specialists of all kinds are in short supply. Patients have to wait eight weeks for an MRI, ten weeks for referral to a specialist, and four months for heart bypass surgery.

Does this sound like the utopian care Canadian politicians promised their constituents? The hard truth is that socialized medicine is destroying health care in Canada.

Most Americans do not understand that we are headed down a similar path in this country. The same mistaken economic and philosophical ideas that created socialized medicine in Canada are leading to semi-socialized medicine in the United States. The increase in managed care, bureaucracy, waiting lists, and expense is largely the fault of the government. In its zeal to "compassionately" meet all of our health-care demands, the government is loving us to death.

How? First, the government pays, through Medicare and Medicaid, over 40 percent of all health-care expenditures. This massive infusion of cash into what were originally unregulated fee-for-service programs fueled demand for medical services, and thus inflated prices. Second, Washington allows tax write-offs to businesses for health insurance, but does not tax workers for the benefits. Consequently, employers have tended to provide comprehensive insurance.

Thus the vast majority of health care is paid for by a third party. Doctors do not have to worry if they are charging too much; the health insurance company (or the government, in the case of the elderly and poor) will pick up the tab. Patients do not have to shop carefully based on prices. Imagine if a third party picked up the tab for any other commodity—such as groceries, rent, television sets, or automobiles. Prices would skyrocket because the consumer would feel no pressure to spend carefully.

While the insurance companies and government, which are paying the bill, cannot shop for the consumer, they can place controls on the patient's freedom of choice. In the 1980s, Medicare officials began to set price controls ("Diagnostic Related Groups," or DRGs) on treatments for the elderly. In the 1990s private health insurance companies followed suit, by expanding Health Maintenance Organizations (HMOs) and other forms of managed care that often arbitrarily decide who may and may not receive treat-

Dr. Hurd is a psychologist/author residing in Maryland.

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ment. Yet there was no alternative to such cost-saving steps, since without some kind of controls the price of medicine would rise ever higher. In that case there would have been pressure on the government to take over altogether, yielding something akin to the Canadian system: monopolistic, post office-style medical care.

Yet the growth of managed care has resulted in American patients encountering problems similar to those faced by Canadians—waiting lists for appointments, arbitrary treatment decisions made by bureaucrats rather than by physicians, and new price and treatment controls in government programs such as Medicare. Today the United States teeters on the brink of a Canadian-like system.

A Free Market in Medicine: The Unknown Ideal

How did we get to this point? And, more importantly, how can we reverse course and prevent a plunge into the disaster that Canada now faces? The answer is real capitalism.

Patients would be free to pursue any treatment they wanted. They would also be responsible for payment, encouraging them to select the best price available among competing medical providers and hospital insurance carriers.

Doctors and hospitals would be free to charge what they believed their services were worth; but they would also have to compete in a marketplace where they risked losses if they charged significantly more than their competitors or more than what most people were willing to pay. Patients, shopping as informed consumers in the marketplace, would do the cost-cutting that the HMOs and government bureaucrats currently do far less efficiently. Just as capitalism (or, more specifically, the law of supply and demand) succeeds in making food, computers, and other goods widely available at prices everyone can afford, so too with medicine and hospitalization insurance—if only the government would get out of the way and let the marketplace work.

The basic principles of economics would work no differently in the medical marketplace than in any other. The fact that medical treatment can be a matter of life or death does not prevent economic principles from operating. On the contrary, the life-or-death nature of medical treatment makes it all the more urgent that the government allow the marketplace to function rationally.

Restoring the marketplace requires aggressive free-market reforms. This means adjusting the tax law to end the subsidy for expensive comprehensive insurance. Moreover, Medicare should be privatized. One possibility would be to maintain the program for the current elderly, offer a phase-out option utilizing medical savings accounts (akin to IRAs) for the middle-aged, and inform young people that they will be responsible for saving for old-age medical care.

Socialist Principles Remain

The problem is not just getting people to understand economics, however. Despite the collapse of communism throughout the world, and the failure of welfare-state democracies in Western Europe, American politicians of all stripes still insist that more government control over health care is needed.

How can this be? In a recent Canadian survey, the majority of respondents stated that their socialized system, for all its problems, reflected their collective "generosity and compassion," and gave them at least one clear claim to being "morally superior" to the United States. Imagine! A socialist system that provides—indeed, even mandates—pain, suffering, inefficiency, and stagnation is considered to be morally superior to a capitalistic system which (when allowed to function without interference) promotes competition, technological superiority, affordability, and individual respect. In other words, it is better for everyone to have mediocre (or worse) medical care, as is the case in Canada, than it is for there to be any variation in care. Unfortunately, Americans, too, are increasingly choosing this same ethical perspective.

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The "Right" to Health Care

This attitude is reflected in the belief that health care is a "right." Dr. Ted Rumble, an orthopedic surgeon in Toronto who is cooperating with the doctors' protest movement in Canada, summed up the issue: "The public doesn't want a high quality medical system, it wants a free system." My own experience suggests that Rumble's statement applies as much to the United States as to Canada. Many people resent the fact that they cannot have something for nothing, particularly medical care. In a way, who can blame them? Government health policies already make nearly everyone dependent on a third party. So many American adults feel that their medical care should just be available—somehow—as if health care grew on trees.

The result is a refusal to deal with reality. The mere fact that health care, or whatever else, for that matter, does not grow on trees is irrelevant. "There ought to be a law" to make the desired good or service grow on trees. Of course, politicians are always delighted to participate in the charade, if it means advancing their short-term interests.

This is evident in Canada, where frustrated citizens don't want to replace the socialized system with a free market, but rather, to increase government's power to limit "unnecessary" medical visits. In a word: rationing. The childish attachment to the idea of government medicine, in Canada and elsewhere, appears at times almost mystical. A *New York Times* reporter has described the "sacred place in the shrine of Canadian values" its citizens seem to hold for its disastrous medical system. Similar sentiments are obvious in Great Britain, where former Prime Minister Margaret Thatcher could implement no real reforms in the socialized medical system, despite its obvious failures.

Incredibly, the Canadian survey actually found people divided over whether doctors should tell patients that their treatment may not be the best available. (A similar debate is currently underway in the United States over whether HMO doctors should tell their patients when they are being denied superior treatment.) A significant number said they would have more peace of mind simply not knowing. Psychologists call this "denial."

Doctors Fight Back: Medicine's Last Chance

In the midst of the Canadian health-care crisis (and the growing American one) there exists one hopeful development: the protest of Canadian doctors against the socialized system. More and more doctors are refusing to accept new referrals. They are pressuring the government to reduce what it takes from them for alleged "administrative costs." They have also fought the government's attempt to force urban Toronto doctors out of their practices into more rural areas farther north. Some 700 doctors fled Canada for the United States last year, more than twice the number who emigrated ten years ago. If Canadian physicians can find the courage to fight irrational and unjust government mandates, then perhaps American doctors—who still enjoy more freedom than their Canadian counterparts—can muster the same courage.

Doctors must not be afraid to point out that capitalism delivers the goods. Because it respects the rights of the individual, it is the only proper, humane, and moral social system. Moreover, great medical care would never have been possible in a society that did not respect the rights of doctors. When told about a patient's refusal to pay for his services, Dr. Aaron Shutt, a fictitious surgeon in the CBS television series "Chicago Hope," stated: "It's not about money. It is about respect. Surgery is my art. It's my craft. It's mine to sell; it's mine to give away. People . . . think it's free for the taking. Well, it's not. And I'm going to do something about it."

It's time for all doctors to do something about it. □

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THE FREEMAN
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Electrical Utilities: The Final Deregulatory Frontier

by Doug Bandow

Up into the 1970s electrical utilities were one of the least likely candidates for deregulation. The industry was littered with local and regional government enterprises and state and federal subsidies. Private power companies were thought to be "natural monopolies" and therefore were established as monopoly franchises regulated by government commissions. The public interest was thought best served by suppressing competition and guaranteeing a set rate of return.

Since then the world has changed greatly. In the United States controls have been lifted or reduced in the airline, banking, broadcasting, citrus, energy, natural gas, oil, rail, telecommunications, telephone, and trucking industries. The move to freer markets has been even more significant abroad, affecting not only Third World states but also the one-time communist empire.

Moreover, states, the federal government, and foreign nations have begun to apply the same principles to power generation. A test group of New Hampshire residents has been bombarded with offers from some 30 different power producers as part of a New Hampshire pilot program; bills have dropped by an average of 15 to 20 percent. Potential savings from full competition could range up to 40 percent. Merely a one cent per kilowatt-hour drop would save $28 billion nationally. Pressure is growing to transform the entire industry through competition. Observes Elizabeth Moler, chairman of the Federal Energy Regulatory Commission, "The future is here, and the future is competition."

Doug Bandow, this month's guest editor, is a senior fellow at the Cato Institute and the author of The Politics of Envy: Statism as Theology.

The Electricity Market

Monopoly provision of power was not inevitable. Early power companies, which date to 1879, relied on public streets to transmit electricity. Many municipalities granted competing franchises. In 1905, however, New York and Wisconsin began the shift toward government control. What Robert Bradley of the Institute for Energy Research terms "the cumulative march of regulation" reflected the reigning Zeitgeist of the Progressive Era, with its belief in public management.

The formal justification was that competition was wasteful. Electrical generation and transmission, it was said, was a "natural monopoly." In fact, regulation turned into a happy meeting point for activists philosophically predisposed to government control, if not ownership, and businessmen who preferred guaranteed returns to the vagaries of the marketplace. Research indicates that regulation was first imposed where electrical rates and producer profits were lowest—suggesting vigorous competition. The result of regulation was to raise both.

The ultimate outcome of this shift from competition to regulation was a mixture of

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government enterprises, government-subsidized cooperatives, and regulated monopoly franchises. As early as 1882 municipalities had begun to establish their own utilities. Federal power generation began in 1909, after President Theodore Roosevelt ended private access to public waterways. In 1933, Congress created the Tennessee Valley Authority, which combined federal power with economic development and pork-barrel politics. Also important are rural cooperatives, which were originally established to bring power to America's less developed areas.

But still most important are the investor-owned utilities (IOUs). The IOUs were granted geographically exclusive franchises and subjected to extensive state review, usually by an independent commission whose members were appointed in some states and elected in others. Nevertheless, state authorities had trouble controlling interstate power transfers and regulating multi-state holding companies. In response to these perceived problems, Congress passed legislation authorizing the Federal Power Commission to regulate interstate transmission of power.

The process worked relatively smoothly until the so-called energy crisis of the 1970s. In large part this reflected the fact that until then electricity prices had been generally falling or rising only slowly. That changed in the 1970s, however. Rates began to move upward with successive oil price shocks. Compliance costs with the Clean Air Act, passed in 1970, and other environmental regulations significantly affected the cost and pace of new plant construction. Rising interest rates had a particularly injurious impact on the capital intensive electricity industry. Higher electricity charges sparked public opposition.

As the existing industry structure shuddered, some regulators and politicians began to look at the possibility of relying on market forces. By the end of the 1980s, proposals for deregulation were percolating in more than 20 different states. Congress passed the Energy Policy Act of 1992, which allowed the Federal Energy Regulatory Commission (FERC) to require IOUs to "wheel" bulk power (wholesale to other utilities) on their transmission lines. Thus, independent power producers could produce energy for sale to utilities. In 1994 the California Public Utility Commission voted to take the logical next step of retail competition. A number of states are now proceeding with plans to test retail wheeling. Some of the same ideas have been advanced overseas, particularly in Europe.

Even industry executives, many of whom remain fearful of such changes, recognize that deregulation is coming. Exactly what form that should take for utilities remains highly controverted. Nevertheless, the end point is clear: market forces should be allowed to determine the generation and provision of power.

Government-Owned and Subsidized Power

The first step in any deregulation program should be to level the energy playing field. While IOUs have, at least until recently, benefited from their status as protected monopolies, they have faced competition from public and quasi-public entities with even greater advantages. Government-subsidized power comes in several forms.

One is the roughly 1,800 municipally owned utilities across the nation, which account for about 15 percent of power distribution. Local public systems typically charge less than their private equivalents, but this reflects government favoritism, not economic efficiency. Being exempt from most state and federal taxes, municipals face an overall tax burden about one-seventh that of IOUs.

Municipalities also can issue tax-exempt bonds, which require lower interest rates. Many states provide subsidized credit, further advantaging municipals. The federal government provides preferential access to power generated by its power-marketing authorities, which sell power for 2.5 cents per kilowatt-hour, barely 40 percent of the national average. Finally, urban systems are usually exempt from regulation by state commissions. These generous subsidies go to wealthy cities like Aspen and Los Angeles.

Similar in certain ways are the 900 cooperatives (owned by their customers), which

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account for about eight percent of the country's energy demand. They are also generally exempt from state and federal taxes and receive preferential access to federal power. Moreover, they have their own federal agency, the Rural Utility Service, formerly the Rural Electrification Administration (REA), with no purpose in life other than to transfer taxpayer resources to the co-ops.

Even when the REA was created in 1935 the agency's primary justification was political. Although only 12 percent of American farms then had electricity, IOUs were steadily expanding service in rural areas. The REA became a political behemoth constantly in search of new tasks to fulfill, expanding into phone service, and, briefly during the Carter administration, cable television. Unfortunately its activities have come at high cost: as much as 40 percent of its roughly $43 billion loan portfolio may have to be written off.

The agency has lost all pretense of purpose. Today more than 99 percent of farms have electricity. Co-ops now largely serve urban and suburban America. Indeed, supposedly rural co-ops service exotic Hilton Head Island and elite Vail, as well as the suburbs of Atlanta, Dallas, and Washington, D.C.

All told, it has been estimated that municipal and cooperative utilities receive about $8.7 billion worth of government aid every year. Looking at the subsidies from a different perspective, the federal government alone is forgoing revenues—taxes on municipalities/co-ops and their investors, and charges for federal power—of about $8.4 billion annually. State and local governments are yielding up a similar $2.7 billion in revenue. The rates of municipals and cooperatives would have to rise by 17 percent and 16 percent, respectively, without the subsidies.

The federal government runs six major power generation and distribution systems. Created first, in 1933, was the Tennessee Valley Authority, which was to provide power to citizens within its own region. Congress financed the construction and initial operation of what has become a multi-billion-dollar system. Again, the initiative was preeminently a political move, since the federal government had consistently rejected proposals to allow comparable private power development. Although no longer the recipient of annual appropriations, the TVA can still borrow at below-market rates through the Federal Financing Bank. It is also not subject to the same taxes as are IOUs.

Similar in purpose, if somewhat more limited in scope, were five other regional enterprises, known as power marketing administrations (PMAs). The first was the Bonneville Power Administration, created in 1937 to provide power to the Northwest. Here again the federal government financed power construction and operation and offered preferential access to its cut-rate power to public utilities or private cooperatives. Today the PMAs encompass 129 power plants and produce about six percent of the nation's electricity.

As America moves toward a competitive system, cities should simply sell off their public power systems—collectively worth an estimated $17 billion. These systems, along with the co-ops, should be stripped of their preferential treatment, both exemption from taxes and access to federal power.

All of the federal enterprises should also be privatized. Doing so could bring in between $20 billion and $40 billion. At the very least, Congress could begin privatizing individual dams and plants and circumscribing the operation of the PMAs. It certainly should cut off new taxpayer subsidies—$312.5 million last year. The PMAs should sell their power at market rates, which could bring in up to $3.6 billion. Congress should cut off the PMAs' subsidized borrowing, worth about $1.2 billion a year.

Subsidies to Alternative Producers

The so-called energy crisis of the 1970s sparked federal interest in both alternative sources of power and conservation. Support at times veered toward fanaticism—federal controls over office temperatures, massive subsidies for uneconomic energy sources like synthetic fuels, and more. A more moderate manifestation of this sentiment was the Public Utilities Regulatory Policy Act of 1978 (PURPA).

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Utilities were required to buy energy from "qualifying facilities," co-generators and independent producers that met specific criteria, at the "avoided costs" of building new generating facilities or purchasing elsewhere, the interpretation of which was largely left to state regulatory commissions. Today the contribution of co-generation remains modest, while that of other non-utility generators has become significant.

Although the law forbade commissions from setting prices higher than the "avoided cost" of additional generation capacity, they had significant discretion in deciding what constituted avoided costs, and some set unrealistically high prices. Among the QFs that sprang forth were "windfarms," solar power projects, and small hydro systems across the country. Many of these contracts live on, with long-term prices set well above market rates. The result is to inflict high-cost energy on IOUs, costs which must be passed on to consumers. All told, Resource Data International, Inc., figures that PURPA will inflate utilities' costs by $37 billion through the year 2000. Some estimates run higher.

PURPA should be repealed. There is no reason to continue requiring utilities to purchase inefficient, wasteful, high-cost energy. The only issue is whether to grandfather in existing QFs. Some $40 billion has been invested in independent power projects across the country, a substantial portion of which would be a risk without government protection. However sympathetic their case—they did, after all, make their investments in reliance on the existence of PURPA—vesting property rights in an existing regulatory regime risks imposing losses on even more innocent parties (in this case, consumers and utilities) and ossifying whatever system happens to exist (since the compensatory costs are potentially so high).

Promoting Other Social Objectives

One method politicians use to win votes at other people's expense is to require utilities to promote a variety of social objectives. For instance, concern about the poor has led to special "lifeline" rates, subsidized by other ratepayers. Environmentalists have been assuaged by the requirement that utilities offer mandatory energy audits, subsidize energy conservation, and the like.

Unfortunately, mixing purposes (energy production and poverty relief) almost always gives the worst of both worlds—more costly service and worse policy-making. For instance, utilities have no more responsibility than supermarkets to lower their prices for lower-income people. Moreover, hiding poverty alleviation in utility rates distorts public decision-making.

Mandatory energy conservation also makes no sense. There is no energy shortage; supplies of recoverable petroleum reserves, for instance, have been increasing. The crisis of the 1970s reflected perverse government policy, not lack of energy. Nor is there any reason that the consumer who desires an audit—which will, of course, primarily benefit him or her—should not pay for it. Or a utility, believing such a program to offer a financial or competitive advantage, could offer such a service gratis. States should drop their mandates and the federal government should avoid imposing its own. In short, deregulation should mean deregulation.

Holding Company Regulation

In 1935 Congress passed the Public Utility Holding Company Act (PUHCA). The legislation broke up large holding companies that controlled multiple utilities. The basic justification for the Act reflected more New Deal ideology than genuine economic problems. Observes Richard Gordon of Pennsylvania State University: "The evidence suggests, however, that the holding company development process was one of competition to effect what seemed a badly needed rationalization of the then-prevailing structure." PUHCA disassembled economical operations and encouraged other, less economical integration. Equally important, the statute hampered future integration, forcing IOUs to rely on voluntary cooperation, which, though often successful, lacked the legal certainty of formal integration.

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The law makes no more sense today and should simply be repealed. If utilities are going to be subject to competition, they need the freedom to structure themselves to best meet the new competition.

The Electric Grid

The development of a national transmission network, or grid, has helped make an electricity free market possible. Within the larger regional networks (east, west, and Texas) exist smaller networks and power pools of cooperating utilities. This electricity superhighway is, of course, privately owned by the IOUs. However, their ownership is often recognized only in the breach. PURPA allows QFs, essentially competitors of the private utilities, to request that FERC require one or more utilities to wheel their power. Later legislation did the same thing for additional independent power producers. In 1996 FERC issued two orders further opening up transmission lines to competitors.

A move to retail wheeling would likely extend this control far further. This is not an economically inevitable outcome of deregulation—the market could be left to develop with IOUs in full control of their transmission facilities, which would obviously limit competition until alternative grids were established. But alternatives would arise, absent the existing government monopolies: already cable TV, gas, and phone companies, railroads and other enterprises own significant rights of way. In fact, William Niskanen of the Cato Institute suggests that the government not mandate access, and instead allow utilities to charge the market price for transmission; provide "the same access to public rights of way that have been granted to the utilities"; and allow other companies with their own rights of way, such as railroads, to develop transmission facilities. Major consumers and groups of consumers would also have an incentive to develop their own grids.

Moreover, a range of academic research raises serious questions about the ability of regulation to ultimately have much impact on industry profits or services. Competition is a much better protector of consumer interests.

Nevertheless, legislators are unlikely to leave IOUs with even a temporary unregulated monopoly. Thus, most proposals for moving to retail wheeling would expand government control by mandating that utilities carry power for their competitors. In the short term (until the construction of alternative distribution facilities), retail competition is possible only through regulation. However, such regulation would amount to a takeover of the utilities' resource, effectively an exercise in eminent domain by government which, under the Fifth Amendment, should require compensation. (Such an action would not necessarily meet the current court test of the Fifth Amendment, which allows a plethora of de facto takings through regulation.)

The issue is not the cost to the individual utilities involved, though wheeling is not free. There is a more basic question: the right to property, which requires a legal ability to exclude others. Forcing IOUs to transmit electricity on behalf of others, particularly their competitors, obviously circumscribes the right of utilities to their transmission systems. For such a violation, or "taking" (if only partially) at the hands of government, they deserve compensation. Moving to a free market means just that, and one important aspect of which is to respect private property, even that owned by utilities.

"Stranded Costs"

Although competition would prove enormously beneficial to consumers, its impact is likely to be less benign on existing producers. The most important problem of reconciling the old order with the new is the treatment of past utility generation investments which were to be paid off through regulated utility rates in coming years.

The basic difficulty is quite simple: investment decisions made in a system of guaranteed contracts for wholesalers, protected monopoly for retailers, and political interferences by legislators and regulators, will not necessarily be the same as the best decisions in a free market. As a result, warns a study by the Edison Electric Institute: "if utility rates were 'brought to market' immediately by

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competition, some costs associated with generation investments, purchased power commitments and other deferred costs would be 'stranded'."

In fact, stranded costs occur throughout the economy in the sense that competition and technological innovation constantly make some investments uneconomic. These are almost always uncompensated. However, stranded costs that result from changes in government policy, such as deregulation, raise additional issues. After all, investors in competitive markets understand the risk of change better than investors in regulated industries.

Estimates of the value of utility assets that would be "stranded," and not likely to be recovered, once prices are competitively set, range from $20 billion to $500 billion, with $100 to $160 billion the most common. In an industry with $175 billion in shareholder equity, even a partial write-down would result in significant shareholder misery. It would also have a major impact on investors holding utility bonds.

Not surprisingly, the IOUs argue on behalf of recovery of stranded costs. They mix equity and efficiency arguments, grounded in what economists William Baumol and J. Gregory Sidak call an "implicit regulatory compact." That is, utilities agreed to invest in exchange for the promise of a reasonable rate of return.

Although utilities understandably desire full coverage for investments devalued by deregulation, as a general principle it is neither fair nor practical to turn regulatory expectations into property rights. The very pervasiveness of regulation makes fiscally infeasible any uniform attempt to compensate for regulatory expectations. Nor would it seem appropriate to dump that burden on consumers who were the very people paying artificially high prices in the past. Indeed, the basic principle might be termed: he who lives by the sword dies by the sword. That is, investors who put money into a regulated industry must understand that the regulations are artifacts of government policy and not property rights. That means they can be changed. And those changes are a risk of the investment.

Nevertheless, the utility industry presents some special circumstances that make the case more difficult. Although industry regulation is pervasive, it usually has not been structured to so consistently encourage high-cost capital investment. Government limits on profit-taking also raise issues not present with simple restraints on competition. Since IOUs were denied the ability to make potentially lucrative returns on those investments when regulated, they reasonably argue for recovery or mitigation of the losses as government lifts the regulation. On the other hand, however unfair deregulation might seem in such a case, the IOUs and their investors always knew that the law and rules could change. Indeed, the 1970s should have brought that lesson home to some degree, since once-routine rate increase proceedings became increasingly contentious. A fair bottom line would suggest showing some sympathy for the utilities' position, but leaving them with the majority of the downside risk for their investments.

Another issue involves particular obligations imposed on the industry but not new competitors. For instance, to maintain PURPA in an otherwise deregulated market would force utilities to pay above-market prices for energy, hardly a prescription for effective competition. Similar are energy conservation programs, low-cost "lifeline" initiatives, and other money-losing initiatives now imposed on utilities but for which the costs have been recoverable when competition is banned and rates are regulated. As argued earlier, government should end its forced exactions. If not, the utilities deserve compensation.

In short, distinctions should be drawn based on responsibility (utility decision or regulatory change) and potential for mitigation (also by utility or government). The presumption should be that in cases where government caused or failed to mitigate the stranded costs (like PURPA), they are recoverable. Where the stranded costs were caused or not mitigated by industry, the presumption would be only limited reimbursement.

The utility market, especially with the advent of wholesale retailing, is a national one. Over the years Congress has intruded in a number of ways. Thus, deregulation requires at least some action at the national level.

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Whether Washington should establish the basic framework or draft the detailed blueprint for deregulation is less clear. At one level, it makes sense to provide for a consistent development of the national electricity marketplace. Thus, the case for federal preemption is strong.

Nevertheless, federalism is an important principle. Although today honored more in the breach than in practice, there is a principled argument for devolving policy decisions and shrinking the power of the Leviathan now centered in Washington. In this case the federal government might bar barriers to interstate commerce (such as excessive "exit" fees for current customers to switch utilities), but allow states to impose a variety of regulations (such as DSM programs and stranded cost recovery) on any company serving residents. Allowing states to test different policy options would be particularly helpful in cases where the best policy outcome is unclear.

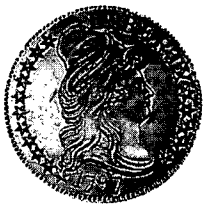
Where Do We Go from Here?

The electricity industry is almost certainly heading into a period of unparalleled change. Given changing demand, economics, and technology, the electricity sector is facing revolution rather than reform. At such a time every government statute, regulation, and preconception should be put into play. Whatever the exact transition, the ultimate goal should be a deregulated free market of the sort that characterizes most of the rest of the economy. Said Alvin Duskin of U.S. Windpower: "There has to be some solution to the regulatory process that doesn't include more regulation."

The prescription of a free market does not mean that government should design the market. Only by freeing up both consumers and producers will we likely reach the most efficient end-point. But getting from here to there, wherever it is, will not be easy. The policy ideal is relatively simple: repeal most everything. Politics is likely to get in the way, of course, and compromise is inevitable. But there's no reason for pre-emptive surrender, offering supposed deregulation measures that would impose new restrictions.

Deregulation's time has come. Then the American people will eventually enjoy the benefits of freedom when they turn on the light or heat just as they do now when they purchase the lamps and furnaces which run on electricity. □

At What Price Will The Gold Standard Return?



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THE FREEMAN
IDEAS ON LIBERTY

Edward Coke—Common Law Protection for Liberty

by Jim Powell

Why were civil liberties first secured in England?

One important reason was the development of common law principles and precedents independent of a ruler. Edward Coke (pronounced "Cook") was more responsible for this than anybody else. Murray N. Rothbard called him a "great early seventeenth century liberal." Winston S. Churchill observed that "His knowledge of the Common Law was unique." Historian George Macaulay Trevelyan considered him "one of the most important champions of our liberties." F.A. Hayek referred to him as "the great fountain of Whig principles."

Coke had a gift for expressing common law principles in unforgettable ways. "The common law," he wrote, "is the best and most common birth-right that the subject hath for the safeguard and defense, not merely of his goods, lands and revenues, but of his wife and children, his body, fame and life. . . . No man ecclesiastical or temporal shall be examined upon secret thoughts of his heart. . . . the house of an Englishman is to him as his castle."

As a lawyer and judge, Coke worked with arguments based on precedents, which one might think would mean that if he couldn't cite precedents he didn't have a case. But he was the best at discovering precedents for liberty. If at times he claimed that precedents went back farther and proved more than they actually did, he was almost always right about fundamental principles.

His *Reports* and *Institutes* did much to give the English a coherent constitution. Even his rival Francis Bacon conceded: "Had it not been for Sir Edward Coke's reports . . . law by this time had been almost like a ship without ballast; for that the cases of modern experience are fled from those that are judged and ruled in former times."

Although Coke embraced conventional religious beliefs, he did much for religious toleration. As Chief Justice of common law courts, he worked to keep many cases out of ecclesiastical courts that sentenced religious dissenters to be tortured, imprisoned, or burned. He appointed Puritan ministers to the churches he owned. He hired an independent-minded secretary named Roger Williams, who went on to establish Rhode Island as a sanctuary for religious toleration. At Coke's death, his personal library included major Puritan writings of the previous half century.

Coke was more than a jurist; he deserves much credit for the emergence of representative government. Under Queen Elizabeth I, Parliament was a cipher for the monarch.

Mr. Powell is editor of Laissez Faire Books and a senior fellow at the Cato Institute. He has written for the New York Times, *the* Wall Street Journal, Barron's, American Heritage, *and more than three dozen other publications.* *Copyright © 1997 by Jim Powell.* *Thanks to Charles M. Gray for reviewing this article.*

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Members of Parliament lacked the ideological vision as well as practical experience to provide effective opposition or leadership. In 1621, 1624, 1625, and 1628, Parliament spearheaded attacks against the ministers of James I and Charles I. Parliament articulated constitutional principles and took initiative in formulating policy. Coke certainly wasn't the only important figure in these parliaments, but he framed the issues, served on more parliamentary committees, delivered more committee reports and speeches than anybody else. He did much to secure the principle that ministers must be accountable for their actions—a critic remarked that Coke "would die if he could not help ruin a great man every seven years." His ideas helped inspire the revolution which, two decades later, toppled Charles I.

"Coke's great influence both in the Commons and in Parliament as a whole is easily explained," according to Wesleyan University historian Stephen D. White. "His extensive governmental experience both in and out of Parliament and his formidable legal reputation naturally brought him respect from other members. He had held many high offices in both central and local government.... He had participated in every meeting of Parliament since 1589, had served as Speaker of the Commons in 1593, and was an expert on parliamentary precedents and procedure. And his published writings and his years as a judge and legal officer of the crown had established his reputation as the most eminent legal authority of the era."

Coke has had an enormous influence in America. Coke's principal legacy: the independence of the judiciary and the principle that judges may overturn statutes which are contrary to the Constitution.

An Imposing, Difficult Man

Biographer Catherine Drinker Bowen noted that "Coke stood out above a crowd, a noticeably handsome man, tall, big-boned, inclined to spareness. His face was oval and a trifle long; between mustache and pointed short beard the lower lip showed full and red. Dark hair, cut even with the ears, had as yet no trace of gray but had begun to recede at the temples, accentuating the height of his forehead. Coke's eyebrows were heavy and smooth, his complexion somewhat swarthy; there were few lines to his face. His eyes, large, dark, and brilliant, bore the watchful look of a man ambitious and self-contained."

Coke, to be sure, was often a difficult character. "Pedant, bigot, and brute as he was," historian Thomas Babington Macaulay wrote in his essay on Bacon, "he had qualities which bore a strong, though a very disagreeable resemblance to some of the highest virtues which a public man can possess.... He behaved with gross rudeness to his juniors at the bar, and with execrable cruelty to prisoners on trial for their lives. But he stood up manfully against the King and the King's favourites. No man of that age appeared to so little advantage when he was opposed to an inferior, and was in the wrong. But, on the other hand, it is but fair to admit that no man of that age made so creditable a figure when he was opposed to a superior, and happened to be in the right."

Edward Coke was born with law in his blood, February 1, 1552, in Mileham, Norfolk, England. His father, Robert Coke, was a lawyer practicing in London and Norfolk. His mother, Winifred Knightley, was the daughter of an attorney.

After attending the Norwich Free Grammar School for seven years, Coke entered Trinity College, Cambridge, and was four years there. Destined for a legal career, he began studying at Clifford's Inn in 1571 and the next year transferred to Inner Temple. These were guilds where young men went to acquire knowledge of common law that would be needed for professional practice. Common law was the law applying to everyone. It included Saxon legal customs, standard commercial practices for resolving disputes, parliamentary statutes, judicial decisions and, yes, some royal decrees. In addition, there were treatises going back several hundred years, written by respected judges like Henry Bracton, Anthony Fitzherbert, John Fortesque, John Glanville, and Thomas Littleton. Students of the common law had to learn "law French," the language of common law plead-

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ings, and Latin, the language in which medieval court records were kept. Coke began a lifelong practice of arising at 3:00 A.M. so that he could gain several hours for learning more about law before the day began.

Coke started practicing law in 1578. He spent a lot of time in Coventry, Essex, Norwich, and London, and he always had a notebook which he filled with his observations about courtroom proceedings. He was to continue recording his observations for more than four decades—they became the basis of the published works that secured his reputation.

When Coke was 30, he married 17-year-old Bridget Paston, who descended from a wealthy Suffolk family and came with a dowry of £30,000. He developed ties with Lord Burghley, a councilor to Queen Elizabeth. After a succession of minor positions, he was appointed Solicitor General by Queen Elizabeth in 1592. She named him speaker of the House of Commons the following year, and in 1594 chose him over Francis Bacon to be attorney general.

Francis Bacon

Bacon and Coke were to be rivals for nearly three decades. Bacon, nine years younger than Coke, was the son of an Elizabethan courtier, the Lord Keeper of the Great Seal. Bacon's father died before he could buy his son an estate, so he had to work for a living. He learned law at Gray's Inn, then pulled political strings and got elected to Parliament in 1584. He urged religious toleration for loyal citizens, but otherwise he was a thoroughgoing government man. As a consequence, he acquired estates and secretaries, including Thomas Hobbes, who later distinguished himself as a theoretician for political absolutism.

In his lucid essays (first edition, 1597), Bacon expressed admiration for Machiavelli's political writings and declared that governments shouldn't be judged by the moral standards that apply to ordinary people. Bacon made clear his distrust of Parliament and his belief in political absolutism. He approved of war because it promoted a strong state.

Coke, meanwhile, prospered as a vigorous defender of royal prerogative and enforced laws against religious dissenters. His wife died, and he soon remarried Lady Elizabeth Hatton, granddaughter of Lord Burghley and niece of Robert Cecil, the most influential minister of Queen Elizabeth and, for a while, of her successor, James I. This second marriage was rocky, but it brought him even more property.

Coke, unlike Bacon, was critical of patents of monopoly which the government had issued since 1552 to generate revenue. The patents were issued for mechanical inventions, chemical processes, and other things. There were many complaints because patents of monopoly benefited a few individuals at the expense of everybody else. Coke handled some of the most important cases against monopolists. As he explained, "it appeareth that a man's trade is accounted his life, because it maintaineth his life; and therefore the Monopolist that taketh a man's trade, taketh away his life."

England had the lowest taxes in Europe, but toward the end of her reign Elizabeth needed more revenue. After the Spanish Armada was smashed in 1588, Spain built more ships for another possible attack on England, requiring new English defenses. Elizabeth was at war with France, too. Bacon recognized the danger of taxation. In 1593, he remarked: "wee breed discontentment in the people and in a cause of Jopardie her Majesties saftie must consist more in the love of her people then in their welthe."

The Ascension of James I

Elizabeth died on March 24, 1603, and was succeeded by the 37-year-old James VI of Scotland, who became James I of "Great Britain"—he revived the name from early medieval times. Elizabeth, he soon discovered, left a pile of debts. "My lord treasurer," wrote one official in September 1603, "is much disquieted how to find money to supply the King's necessities." This official found "all means shut up of yielding any relief." London bankers twice refused to loan the government any more money, claiming they had suffered

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big losses because of the plague, but Venetian ambassador Nicolo Molin reported: "ill-will is also suspected as the cause."

A monarch was supposed to pay the cost of maintaining his palace and retainers with hereditary income, while Parliament financed national defense and wars. But James asked Parliament—taxpayers—to help cover his extravagant royal household expenses.

The king's personal habits made his political problems worse. "James was a loutish savage," wrote historian Paul Johnson. "When hunting, he liked to plunge his bandy legs into the stag's bowels. . . . He delighted in getting the young court ladies drunk, and seeing them collapse in vomit at his feet. He would sit there, laughing. . . . Everything James did, and everything he omitted to do, was certain to evoke protest."

Attorney General Coke made his reputation as a tough prosecutor in three sensational trials. First came the Earl of Essex, an adventurer who had blundered in Ireland, disobeyed Elizabeth's orders, and burst into her private quarters (1601); Walter Raleigh, who allegedly plotted against James (1603); and Guy Fawkes and his fellow Catholic conspirators who dug a tunnel for 35 barrels of gunpowder under Westminster Palace, which they hoped to blow up when the King and royal family gathered for the opening of Parliament (1605). Coke caused quite a stir as he repeatedly underscored key points, displayed his eloquent Latin, picturesque English, and formidable knowledge of legal precedents.

Bacon and Coke were at each other's throats. Parliament turned down James's request for more revenue, and he attempted an "end run" around Parliament by doubling tariffs, an idea backed by Bacon. James's "New Impositions" meant that imports were subject to the delay and expense of being inspected twice. John Bates, an importer of Venetian currants, tried to evade the "New Impositions" and was brought before the Court of the Exchequer. It ruled that tariff policy was the king's jurisdiction, not Parliament's. The House of Commons named a commission to look into the matter. Coke was the point man. He insisted the king's jurisdiction was to protect England against foreign enemies, but the "New Impositions" were for revenue, and Parliament's approval was required.

"It is odd, indeed," noted biographers Hastings Lyon and Herman Block, "that Bacon, the philosopher, should have failed to apprehend what Coke, the legist, apparently did see: namely, that if the enforced loans, benevolences and monopolies were permitted, the King would have a nearly complete system of extra-Parliamentary taxation, and Parliament would soon become an unnecessary assembly, with a consequent corruption of the State into tyranny."

Chief Justice of the Court of Common Pleas

In June 1606 James appointed him Chief Justice of the Court of Common Pleas, which mostly handled private actions between citizens. This was a position where Coke would have to do the king's bidding or be dismissed. The "New Impositions" didn't generate enough revenue, and soon James issued a writ which forced people in England's seaports to equip his fleet. (Elizabeth had issued such a writ but there was more political support for it because she faced the Spanish Armada.) Coke authored the "Protestations from the House of Commons," which declared, in part, that "from the time of Magna Carta the liberties, franchises, privileges and jurisdiction of Parliament are the ancient and undoubted birthright and inheritance of the subjects of England." This outraged James.

Coke clashed with the king on fundamental issues. "The state of monarchy," James maintained, "is the supremest thing upon earth. For Kings are not only God's lieutenants upon earth and sit upon God's throne, but even by God himself they are called Gods . . . for they exercise a manner or resemblance of divine power upon earth." James, like Elizabeth, considered judges to be agents of the crown. They certainly weren't supposed to render independent decisions.

English common law was a murky field, and Coke made the most of it when countering the king. Judicial decisions weren't systematically

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based on precedents, because it was difficult to determine what the precedents were. "Argument from decided cases, though frequent and persuasive," noted English constitutional law scholar Charles M. Gray, "did not dominate courtroom dialogue. Prior decisions were sometimes followed by judges who professed not to agree with them, but they were sometimes rejected for reason or simply ignored."

On November 13, 1608, there was an epic confrontation between James and Coke. James described judges as "shadows and ministers." Coke replied that "the King in his own person cannot adjudge any case . . . but that this ought to be determined and adjudged in some Court of Justice, according to the law and Custom of England."

James countered "that he thought the law was founded upon reason, and that he and others had reason as well as the Judges." Coke: "God had endowed his Majesty with excellent science and great endowments of Nature. But his Majesty was not learned in the Laws of his Realm of England; and Causes which concern the Life, or Inheritance, or Goods, or Fortunes of his Subjects are not to be decided by natural Reason but by the artificial Reason and Judgment of Law, which requires long Study and Experience before that a man can attain to the cognizance of it."

James was outraged, as one observer reported: "his Majestie fell into that high indignation as the like was never knowne in him, looking and speaking fiercely with bended fist, offering to strike [Coke]."

Meanwhile, Coke labored to share his knowledge of common law. He had begun issuing an annual *Report* on cases in 1600, and he continued until 1616. The prefaces were in English, texts in "law French," and pleadings in Latin. "Anything that could be gleaned in Westminster, London Guildhall or the circuit courts in the counties he set down in his own form and fashion, adding comment, aside, comparison," noted biographer Bowen. "No law reports had hitherto been half so comprehensive; Coke must have lived and walked and sat and talked with notebook in hand. At once the books became—as Blackstone indicated in 1765—an intrinsic authority in the courts of justice."

Bacon, whom James had named Solicitor General in 1607, considered the king *legibus solutus*—above the law. Lord High Chancellor Ellesmere, the highest judicial official, declared *Rex est lex loquens*—"the king is the law."

Bacon advised James, in *Peacham's Case*, to try influencing court decisions by presenting judges with the allegations in a case and asking their opinion before trial. Edmund Peacham was a Puritan minister who criticized a bishop's religious intolerance, for which he was brought before the High Commission. As Bacon reported to the king, "Upon these interrogatories, Peacham was examined before torture, in torture, between torture, and after torture; nothing could be drawn from him, he still persisting in his obstinate and inexcusable denials and former answers." Coke wouldn't cooperate with Bacon, saying that "taking of opinion is not according to the custom of this realm." Coke considered it unfair to present judges with allegations when neither a defendant nor defense counsel were present for cross-examination. Bacon told James that Coke's "over-confidence, doth always subject things to a great deal of chance." Peacham died in prison.

In *Bonham's Case*, Coke ruled that the common law stood above Parliament. The case involved Dr. Thomas Bonham, jailed for practicing medicine without a certificate issued by the Royal College of Physicians. He filed suit for false imprisonment. Coke observed that according to the Royal College's statute of incorporation, it pocketed half the fines from violators like Bonham. This, he noted, meant the Royal College was both a party and judge in every action. Citing a common law principle, *Aliquis non debet esse judex in propria causa* [Nobody should be judge in his own cause], Coke ruled: "in many cases the common law will control acts of Parliament and some times adjudge them to be utterly void; For when an Act of Parliament is against common right and reason, or repugnant, or impossible to be performed, the common law will control it and adjudge such

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Act to be void." This was the most controversial decision he ever rendered.

James asserted his power by issuing proclamations that he insisted had the force of law. In September 1610, Coke presented his view of these proclamations to the Privy Council, which had the responsibility of advising the king on executive, judicial, and financial business and seeing that the king's will was done. "All indictments," he observed, "conclude with the words, Against the law and custom of England, *Contra legem et consuetudinem* Angliae; or against laws and statutes, *Contra leges et statuta*. But I never heard an indictment to conclude, *Contra regiam proclamationem*; against the king's proclamation." Coke went on to review the legal history of royal proclamations. Accordingly, the Privy Council resolved "That the King by his proclamation cannot create any offense which was not an offence before, for then he may alter the law of the land by his proclamation in a high point; for if he may create an offence where none is, upon that ensues fine and imprisonment. Also the law of England is divided into three Parts: Common Law, Statute Law, and Custom; but the King's Proclamation is none of them."

Coke issued "prohibitions" aimed at curbing the power of ecclesiastical courts, especially the High Commission, which imprisoned individuals for preaching Nonconformist doctrines. A prohibition ordered the ecclesiastical courts not to proceed with a case if there was any reason it might belong in a common law court. Coke defended his prohibitions by showing how they had long been issued by common law courts. Moreover, he explained how, during the past 60 years, the High Commission had expanded its power beyond what had been specified in any statute.

James called Parliament in 1610 because he needed money, but Members drew up a Petition of Grievances. Among the principles at stake: "there is none which they have accounted more dear and precious than this, to be guided and governed by the certain rule of law, which giveth to the head and the members that which of right belongeth to them, and not by any uncertain and arbitrary form of government."

James took offense: "We are an old and experienced king, needing no such lessons." Coke rose to defend the Petition: "I never spake but mine own conscience. The privileges of this House is the nurse and life of all our laws, the subject's best inheritance. If my sovereign will not allow my inheritance, I must fly to Magna Carta and entreat explanation of his Majesty. Magna Carta is called *Charta libertatis quia liberos facit*. . . . The Charter of Liberty because it maketh freeman. When the King says he cannot allow our liberties of right, this strikes at the root. We serve here for thousands and ten thousands."

James fumed, "The House of Commons is a body without a head. The members give their opinions in a disorderly manner. At their meetings nothing is heard but cries, shouts, and confusion. I am surprised that my ancestors should ever have permitted such an institution to come into existence. I am a stranger, and found it here when I arrived, so that I am obliged to put up with what I cannot get rid of."

James dissolved Parliament the following year, and Coke stood alone against the king. He issued two rulings that limited the discretionary power of the High Commission. James snapped that the rulings were "of a nature extraordinary and showing more the perverseness of [Coke's] spirit than any other prohibitions." James summoned Coke and several like-minded judges to explain themselves. Coke endured a three-day interrogation.

Chief Justice of the King's Bench

In 1613, Bacon had an idea for taming Coke: promote him to Chief Justice of the King's Bench, which handled criminal as well as civil actions; and promise him a seat on the 12-member Privy Council. "Coke will thereupon turn obsequious," Bacon assured James. Coke became Chief Justice of the King's Bench in October, but Bacon and James were in for a surprise.

Conflict developed when James granted two income properties to the Bishop of Coventry. The grant was contested by two men

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who claimed the property was theirs—this became known as the *Case of Commendams* (which meant the bishop could collect the income while having somebody else perform whatever services might be required). Coke and his fellow judges were about to conduct a hearing on the dispute when James ordered them not to proceed, because his prerogative was at issue. Coke countered that "The stay required by your Majesty was a delay of justice and therefore contrary to law and the Judges' oath." Bacon, who had become Attorney General and a member of the Privy Council, denounced Coke, for behaving improperly. James stepped up the pressure. The judges relented, except for Coke who, a court reporter noted, told the king "That when the case should be, he would do that should be fit for a Judge to do." Coke was dismissed as Chief Justice.

"Coke had not striven in vain," noted historian George Macaulay Trevelyan. "He had enlisted the professional pride of the students of the common law against the rival systems of law specially favoured by the Crown in the Star Chamber, the admiralty and the Ecclesiastical Courts. He had turned the minds of the young gentlemen of the Inns of Court, who watched him from afar with fear and reverence, to contemplate a new idea of the constitutional function and of the political affinities of their profession, which they were destined in their generation to develop in a hundred ways, as counsel for England gone to law with her King."

Coke was so desperate to regain a high position that he pressured his 14-year-old daughter, Frances, to marry John Villiers, the impotent older brother of James's most influential adviser, George Villiers (later the Duke of Buckingham). Bacon filed a complaint against Coke for riotous behavior. This was surely the low point of Coke's career. Although he didn't get back his judgeship, he regained his position on the Privy Council. Apparently, the king and Buckingham still hoped that showing him some favor would undermine his independent spirit. Bacon was subsequently appointed Lord High Chancellor, which made him the highest-ranking person outside the royal family.

James summoned Parliament, which met on January 13, 1621, the first time in seven years. James again needed money, and Members intended to negotiate about their grievances.

Among other things, Parliament was intent on limiting royal power by rooting out corruption. The top target was Buckingham, who had gained considerable influence with the king. After he had sent Walter Raleigh to attack a Spanish settlement in South America, Buckingham did everything he could to appease the Spanish. For a half-dozen years, he schemed to marry James's son Charles, heir to the throne, to the Spanish princess. Since the king still had unlimited sovereignty, it was presumed that a Catholic Queen would mean Catholic heirs, and Catholics could regain control of England.

Buckingham pocketed bribes from those who wanted to get a government job, get a monopoly, get out of jail or advance a lawsuit, and he was summoned before the House of Lords. He apologized for his brothers who had taken bribes and avoided prosecution by sheer political clout. The House of Commons turned to drafting a bill which would curb monopolies.

Bacon's Downfall

The House of Commons then formed a Committee for Inquiring into Abuses in the Courts of Justice. A trail of dubious payments led to Bacon's door. Coke soon emerged as the leading inquisitor. The inquiry against Bacon led eventually to the charge of bribery.

Coke objected to James's proposal that a special commission should investigate the charges, because it couldn't be counted on to recommend prosecution. Accordingly, Parliament began impeachment proceedings for the first time in 160 years. It reported a growing list of bribes. Since the bribes had been delivered in the presence of his servants, Bacon didn't mount a defense. "Condemn and censure me," he wrote the House of Lords—thereby offending the House of Commons.

He was impeached, dismissed as Lord High Chancellor, fined £40,000, imprisoned in the

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Tower of London, then banished from London and the law courts. The historian Lord Acton later remarked, "the Commons, guided by the most famous English lawyer, Coke, struck down Bacon, and deprived the Stuarts of the ablest counsellor they ever had. Impeachment and responsibility of ministers remained."

Coke Imprisoned

On December 18, James dissolved Parliament, and soon afterwards Coke was summoned to appear before the Privy Council. "You have forgotten the duty of a servant, the duty of a Councilor of State and the duty of a subject," he was told. Guards escorted him to a damp, bitter-cold, urine-soaked cell in the Tower of London. Denied access to books, he wrote Latin verses with pieces of coal. He was interrogated by the President of the Privy Council who reported: "I charge you therefore with treason. I have heard you, Sir Edward, affirm that by law he is a traitor who goes about to withdraw subjects' hearts from their King." But after seven months of going through Coke's personal papers and investigating his affairs, crown officials concluded they couldn't find any evidence of wrongdoing. He was released. No charges were ever filed.

The Parliament of 1624 came on the heels of a four-year business depression, and there were a lot of complaints about monopolies. Coke led the attack against monopolies over wool, brick-making, glass-making, salmon fishing, and the transcribing of wills.

James died on March 27, 1625. He had achieved a long period of peace which enabled the English to prosper. But he left a debt of over £200,000. His 24-year-old son became King Charles I, and right away he began spending money at a reckless pace. Then, as Buckingham had arranged, he married the 15-year-old French Catholic princess, Henriette Marie, who came with an 800,000-crown dowry; the idea here was that if there wasn't going to be a marriage to promote peace with Spain, then there should be a marriage to help secure an ally against Spain if needed.

The wedding took place at Notre Dame de Paris, and Charles was represented by a stand-in, the Duc de Chevreuse, because of the risk of Charles falling in the hands of a foreign power. Buckingham himself escorted the new queen back to England, biographer John Bowle reported, with "fifteen lords, twenty-four 'knights of great worth', and far too many pages." Henriette Marie was accompanied by her servants—a bishop and 28 priests.

Thirty Years War

Charles summoned Parliament in May 1625 and faced mounting skepticism. For openers, Members were distracted because several thousand people a week were dying from plague in London. Buckingham had approved military adventures against France and Spain which were fiascos, convincing many Members of Parliament that the previous subsidy they approved was a mistake. Buckingham proposed more military adventures, one to attack Spain and another to save the Protestant Elector of Palatine—which meant becoming embroiled in the conflict that would become known as the Thirty Years War. Parliament voted for two small subsidies and authorized Charles to spend customs revenue only for a year. Charles was in trouble because the Lord Treasurer reported the government didn't have any money or credit left. Assuming Parliament would give him what he needed, Charles had drawn from his own resources to pay £136,000 for a subsidy to Denmark, wages for British soldiers serving in the Low Countries, and food and ammunition for the British navy. "By the grace of God," Charles remarked, "I will carry on the war if I risk my crown." He dissolved Parliament.

Short of money, Charles resorted to conscription. The government rounded up as many able-bodied men as they could find around the port towns. Reportedly many men paid bribes to avoid being conscripted. The government didn't spend money on army barracks, so it forced thousands of private individuals to feed and house the recruits.

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This, of course, provoked widespread resentment, and the result was martial law. The first adventure, against Spain, was a fiasco which Charles and Buckingham tried to cover up, and by the end of the year Charles pawned some of his jewelry and silverware for more money.

Charles summoned Parliament again. In an effort to undermine resistance, he appointed his half-dozen most troublesome opponents, including Coke, as sheriffs, which kept them out of parliamentary proceedings for at least a year. But this enabled a formidable orator, John Eliot, to step forward as a leader. Though he had befriended Buckingham as a young man, he witnessed the return of wretched British soldiers from one of Buckingham's disastrous expeditions against Spain, and he resolved to bring down the Duke. Eliot declared that Parliament wasn't a tool of the king and that Members were morally obligated to follow their conscience. He urged that Buckingham be impeached.

Asked for further subsidy, Members of the House of Commons began impeachment proceedings against Buckingham. Charles responded by ordering Eliot and another outspoken Member, Dudley Diges, imprisoned in the Tower of London. But the Commons charged Buckingham anyway, for failing to suppress piracy in the English Channel, for choosing incompetent leaders of the Spanish expedition, for taking bribes and for scheming with Catholics. On June 12, 1627, Charles dissolved his second Parliament, saving Buckingham's skin.

"At the back of the Parliamentary movement in all its expressions lay a deep fear," explained Winston S. Churchill. "Everywhere in Europe they saw the monarchies becoming more autocratic. The States-General, which had met in Paris in 1614, had not been summoned again; it was not indeed to be summoned until the clash of 1789. The rise of standing armies, composed of men drilled in firearms and supported by trains of artillery, had stripped alike the nobles and the common people of their means of independent resistance. Rough as the times had been in the earlier centuries, 'bills and bows' were a final resource which few kings had cared to challenge. But now on the Parliamentary side force as yet was lacking."

Needing money, Charles resorted to high-handed revenue-raising measures, and on March 27, 1628, Charles summoned Parliament for the third time.

Parliament was aboil over squandered money, conscription, billeting of soldiers in private homes, forced loans. Citing common law precedents, Coke maintained that "the King cannot order any man arrested, because there is no remedy against him." Coke insisted people could be legitimately imprisoned only upon the order of a judge. On March 21, 1628, Coke presented a bill which specified that no one could be imprisoned more than three months without being brought to trial. The House of Commons approved resolutions saying that nobody should be imprisoned unless the government cited the alleged crimes, and the writ of habeas corpus must not be denied.

The House of Commons approved the subsidies that Charles asked for, provided he would agree to respect the liberties of Englishmen. Charles resisted, and the House of Lords was reluctant to break with him. The Lords eventually approved a declaration that the Magna Carta remained in force and that the king must not infringe on "any of his loyal people in the property of their goods or liberty of their person." But then the Lords hedged, suggesting that "as touching his majesty's royal prerogative intrinsical to his sovereignty and entrusted to him from God . . . in the case, for the security of his Majesty's Royal person, the common safety of his people, or the peaceable government of his kingdom, his Majesty shall find just cause, for reason of State, to imprison or restrain any man's persons, his Majesty would graciously declare that within a convenient time, he shall and will express the cause of the commitment or restraint, either general or special."

Coke thundered: "Is the confirmation of the Great Charter a matter of grace? What are just liberties? Who were the best of his Majesty's predecessors? We see what advantage they have that are learned in the law in penning articles above them that are not, how wise soever. What is intrinsical prerog-

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ative? It is a word, we find not much in the law. Intrinsical prerogative is not bounded by any law, or by any law qualified. Admit this intrinsical prerogative, and all our laws are out. This intrinsical prerogative it appears is entrusted to the king by God. It is *jure divino* [divine law]. No law can take it away. His majesty can commit when he pleases."

When the king continued to resist, Coke proposed on May 8 that Parliament adopt a Petition of Right for the king's agreement on "1. The personal liberty of the subject. 2. His propriety in his goods. 3. Unbilletting of soldiers. And 4. Silencing of martial law in time of peace."

Charles dispatched a letter to the Lords, saying he must be able to imprison people without filing specific charges. For 18 days, the Lords tried to figure out how they could draft something agreeable both to Charles and the Commons. Then Coke rose in the Commons and spoke: "Let us palliate no longer. If we do, God will not prosper us. I think the Duke of Buckingham is the cause of all our miseries, and till the King be informed thereof, we shall never go on with honor or sit with honor here. That man is the grievance of grievances. Let us set down the cause of all our disasters and they will reflect on him."

On June 8, Charles met both Houses of Parliament at 4:00 in the afternoon. Then he signified the words of approval which gave a bill the force of law: "*Soit droict fait comme est desire*."

"We reach here," wrote Churchill, "amid much confusion, the main foundation of English freedom. The right of the Executive Government to imprison a man, high or low, for reasons of State was denied; and that denial, made good in painful struggles, constitutes the charter of every self-respecting man at any time in any land. Trial by jury of equals, only for offenses known to the law, if maintained, makes the difference between bond and free."

Coke's Greatest Work

Coke retired to Stoke House in Stoke Poges, Buckinghamshire, just west of London, where he completed his life work.

Scholars traditionally wrote commentaries on established authorities, and that's how Coke proceeded with his greatest work. He prepared commentaries on Thomas Littleton's *Treatise on Tenures*, a fifteenth-century text about land law. "The ornament of the common law," Coke called it, "the most perfect and absolute work that ever was written in any human science, and as free from error as any book that I have known to be written of any human learning." Coke covered about 500 years of English property law.

His health declined in 1634. On June 9, he asked for a pen and paper to affirm his religious faith. While he lay dying, the government—"by order of his Majesty's Privy Council"—issued a warrant to search his house for documents which might threaten the monarchy. Police took manuscripts for his *Institutes* and for two unpublished volumes of *Reports*. Coke died at Stoke House on Wednesday, September 3, 1634, around 11 P.M. A month later, he was buried in the church graveyard at Tittleshall, about six miles southwest of Fakenham, Norfolk, next to his first wife.

Charles trashed Coke's principles. He did everything he pledged not to do in the Petition of Right, and he refused to call another Parliament for 11 years. But the principles had taken root. When the Long Parliament met in 1640, it arranged for publication of the *Institutes* because they "contain many monuments of the subject's liberties."

The Second Part of the *Institutes* appeared in 1642. In this commentary on Magna Carta and almost 40 other charters and statutes, Coke distilled the views he had promoted throughout his public life. He believed individual liberty was best protected by "due process of the common law." He asserted that "Generally all monopolies are against this great charter, because they are against the liberty and freedome of the subject, and against the law of the land." He affirmed that "The interpretation of all statutes concerning the clergy, being parcell of the lawes of the realme, do belong to the judges of the common law."

The Third and Fourth Parts of the *Institutes*

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were published in 1644. The Third Part covered a variety of crimes. Coke defined a crime, explained the penalties, and covered the legal history of it.

The Fourth Part developed his familiar themes about the role of Parliament.

Coke urged his successors in the common law: "And you, honorable and revered judges and justices, that do or shall sit in the high tribunals or seats of justice, fear not to do right to all, and to deliver your opinions justly according to the laws; for fear is nothing but a betraying of the succors which reason should afford; and if you shall sincerely execute justice, be assured of three things: first, though some will malign you, yet God will give you his blessing; secondly, that though thereby you may offend great men and favorites, yet you shall have the favourable kindness of the Almighty, and be his favorite; and lastly, that in so doing, against all scandalous complaints and pragmatic devices against you God will defend you as with a shield."

Coke inspired freedom fighters in England and the American colonies. When Roger Williams established Rhode Island, he reflected in 1652: "how many thousand times since I had the honorable and precious remembrance of his person, and the life, the writings, the speeches, and the example of that glorious light. And I may truly say, that besides my natural inclination to study and activity, his example, instruction, and encouragement have spurred me on to a more than ordinary, industrious, and patient course in my whole course hitherto."

By the time of the Glorious Revolution (1688), long-standing English grievances had been resolved. The monarchy had a Protestant succession. There was a considerable degree of religious toleration. People were protected from arbitrary search and seizure. They couldn't be held in prison unless formal charges were filed, alleging violation of a law. Above all, the power of the monarch was limited by Parliament which had achieved supremacy. Ironically, this meant judges couldn't overturn an act of Parliament. Judges could only rule that the government exceeded the powers granted by a statute—a situation which continues to this day.

The American Founders learned constitutional principles from Coke. Thomas Jefferson remarked that "Coke Lyttleton was the universal elementary book of law students and a sounder Whig never wrote nor of profounder learning in the orthodox doctrines of . . . British liberties." Patrick Henry, John Adams, John Quincy Adams, John Jay, Daniel Webster, and many other influential Americans read Coke. Joseph Story, who became a Jeffersonian Supreme Court Justice, wrote: "When I had completed the reading of the most formidable work, I felt that I breathed a purer air and that I had acquired a new power."

American constitutional historian Bernard Schwartz observed that "The influence of Coke may be seen at all of the key stages in the development of the conflict between the Colonies and the mother country."

Especially since the Constitution was ratified, an independent judiciary and judicial review have become bedrock principles of American law. While judges have made plenty of bad decisions, at least they have the power to strike down unconstitutional statutes, and sometimes they do. This is a big advance from the era when judges were everywhere intimidated into doing what a ruler wanted. Eloquent testimony to the vision, courage, and devotion of Edward Coke. □

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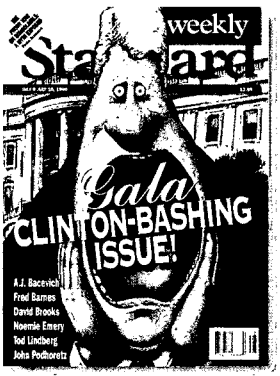

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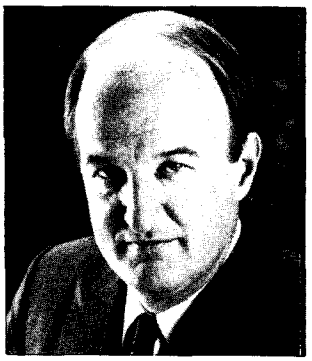

Great Turnabouts in Economics

"There is no harm in being sometimes wrong—especially if one is promptly found out."

—*John Maynard Keynes*

The gradual transformation of Paul Samuelson from Keynesian to classical economics (see my column in the September 1997 *Freeman*) is a major chapter in famous cases of economists changing their minds.

Nobody likes to admit he's wrong. You can probably count on your fingers the number of times scholars have renounced their theories and switched positions. Most academics have a tendency to cling to old dogmas, especially if they have built a reputation on a particular doctrine. We can only admire the scholar who is willing to change when he is convinced by the facts or a new theory. It takes a strong dose of courage and honesty to go against one's vested interest, especially after publishing books and articles on the subject.

Three prominent economists have admitted error and changed their thinking, and we can learn much from their experience.

George Stigler and Antitrust

George Stigler, the towering Chicago professor and Nobel Laureate, was a firm defender of antitrust laws in the 1940s and 1950s. He was influenced by Henry Simon, a leading spokesman for the Chicago School. Simon taught that big business posed a serious problem in the United States and advocated the nationalization of railroads, utilities, and all other "uncompetitive" industries—all in a book ironically entitled *Economic Policy for a Free Society* (University of Chicago, 1948). Stigler moved in a different direction, advocating the breakup of "concentrated" big businesses and punishment of companies engaged in collusion. He appeared before Congress in 1950 and proposed that U.S. Steel Corporation be broken up.

By the early 1970s, however, Stigler had changed his mind. Influenced by the work of Aaron Director and Joseph Schumpeter and a new theory of oligopoly, he found himself shifting his views. "What is still more embarrassing is that I no longer believe the economics I was preaching," he declared.[1] Concluding that concentration did not necessarily lead to monopolistic pricing, Stigler switched positions and actively opposed most antitrust legislation.

Robert Heilbroner and Socialist Planning

For most of his life, Robert Heilbroner, author of *The Worldly Philosophers*, a best-selling history of economics, was a socialist. Under the influence of Adolph Lowe and the New School of Social Research, he became enamored with Marxism. When the Polish economist Oskar Lange assailed Ludwig von Mises's attack on socialist central planning in

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the 1930s, Heilbroner joined the rest of the profession and concluded that Mises was wrong and socialism could work.

By the end of the 1980s, however, Heilbroner dramatically altered his views. In a stunning series of articles in *The New Yorker*, he wrote that the long-standing debate between capitalism and socialism was over, and "capitalism has won."[2] In a follow-up article after the demise of the Eastern Bloc, he was even more explicit: "Socialism has been a great tragedy this century.... But collapse! No one expected collapse.... There is no doubt that the collapse marks its end as a model of economic clarity."[3] Furthermore, the debate between Lange and Mises had to be re-examined in light of contemporary events. "It turns out, of course, that Mises was right," declared Heilbroner. Needless to say, Heilbroner's change of heart did little to endear him to the socialist camp.

Lionel Robbins and Austrian Economics

Not every event is positive for free-market economics. The most notorious example of switching sides occurred when Lionel Robbins, a major proponent of the "Austrian" school of free-market economics, converted to Keynesianism in the late 1930s and early 1940s. In the United States, several prominent classical economists had already changed views, especially Harvard's Alvin Hansen. But Robbins's conversion was infamous because, as chairman of the economics department at the London School of Economics, he had brought Friedrich Hayek from Austria to England, and had been instrumental in translating and publishing Hayek's and Mises's works. He also wrote extensively about Austrian economics, including the illuminating *The Great Depression* (Macmillan, 1934).

However, he fell under the trance of John Maynard Keynes during World War II. In his autobiography, he repudiated the Austrian connection: "I shall always regard this aspect of my dispute with Keynes as the greatest mistake of my professional career, and the book, *The Great Depression*, which I subsequently wrote, partly in justification of this attitude, as something which I would willingly see forgotten."[4]

I should hope that if Lionel Robbins were alive today he would reconsider his views and see the Keynesian episode more of a "diversion" from sound classical economics (to use a term created by Leland Yeager) than as a "general" economic theory. □

Editor's Note: Congratulations to Mark Skousen on his debut as a columnist for *Forbes* magazine. (See the September 22, 1997 issue.) Mark will continue to write his monthly column for *The Freeman*.

1. George J. Stigler, *Memoirs of an Unregulated Economist* (Basic Books, 1988), p. 99.
2. Robert Heilbroner, "The Triumph of Capitalism," *The New Yorker*, January 23, 1989, p. 98. Note he wrote this article before the collapse of the Berlin Wall and the Soviet Union.
3. Heilbroner, "Reflections After Communism," *The New Yorker*, September 10, 1990, pp. 91–2.
4. Lionel Robbins, *Autobiography of an Economist* (Macmillan, 1971), p. 154.

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BOOKS

Everybody Wins! A Life in Free Enterprise

by Gordon Cain

Chemical Heritage Press • 1997 • 342 pages • $24.95

Reviewed by Robert L. Bradley, Jr.

On the surface, this autobiography describes how an individual well past retirement age restructured major assets in the domestic chemical/petrochemical industry through leveraged buyouts (LBOs) to create several billion dollars of wealth for himself and many associates. This interesting and unique business history aside, Gordon Cain's story has a much deeper message—how a "captain of industry" working in a market setting where political barriers and patronage do not apply can create great wealth and opportunities for thousands of people.

As Cain notes in his introduction, the book was inspired by the need to defend his honor against the commonly portrayed notion that debt-financed buyouts in the 1980s benefited a few quick-buck artists at the expense of displaced workers and the general good. He argues that the failure behind massive business restructuring is prior management, not new management. Draconian layoffs and abrupt change could have been mitigated by better managerial decisions and, in turn, more accountable boards of directors. It is passive boards, Cain contends, that can create the "Imperial CEO," an example of that rare species called market failure. But even when the dirty work must be done, Cain explains, a sound entrepreneurial vision can more than offset the transition costs by empowering remaining workers, freeing marginal workers and other nonspecific assets to find more productive employment, and increasing output and lowering prices to benefit consumers.

Cain orchestrated five major business restructurings in the 1980s, all of them LBOs, that handsomely benefited himself, the institutional investors, over 100 key managers, and some 5,000 employees who received several times their salary in stock participation. His largest deal, circa 1989, was his best. Cain Chemical increased 44 times in value for shareholders in the nine months between when Cain put the company together and Occidental bought it. (Cain did not want to sell, but too many people stood to make significant wealth for the first time.) Soon after, Cain opened up his copy of the *Wall Street Journal* to find a full-page advertisement with a "thank you, Gordon Cain" surrounded by signatures from all 1,337 employees, the lowest paid of whom had received a six-figure payout.

While returns of this magnitude always reflect fortuitous circumstances, Cain clearly was doing some highly innovative things that the incumbents (the asset sellers) were not. One innovation that simultaneously cut costs and enhanced corporate decision-making was to increase the involvement of rank-and-file employees. This was accomplished using Edward Deming's "total quality control" concepts and setting up employee stock ownership and profit-sharing plans. By betting on the collective wisdom and drive of the on-the-spot employees rather than intermediate management, Cain had tapped into the same knowledge dynamo that "Austrian School" economists such as Ludwig von Mises and F.A. Hayek had conclusively shown make market economics inherently more wealth-creating than centrally planned ones.

The double win of reduced management costs and improved decision-making allowed Cain to slash overhead from 15–20 percent of sales to around 5 percent of sales and make innumerable process improvements. This endogenous improvement, leveraged by debt financing, was powerfully joined by improved external factors driving the highly cyclic businesses he invested in. Cain repeatedly demonstrated that he understood where he was in the chemical-petrochemical price cycle better than the prevailing view. It is surprising, in retrospect, that so many companies would sell their assets to Gordon Cain.

The crucial element that put Cain's entrepreneurial vision into play was debt financing—and hence his inspiration to offer a revisionist view of the social beneficence of LBOs. Cain had very limited venture capital but a proven management record. Before, this would not have been enough to compete for corporate control. But in the early 1980s a new investment vehicle came of age—high-risk, high-return "junk" bonds to finance leveraged buyouts. Cain's success belies the widespread idea that "junk bonds" and LBOs were evil and fraudulent.

As unique as Cain's late success in business life was his appreciation and support for consistent free-market public policies. While many business executives typically are strong supporters of the free-market economy in the abstract, very few

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resist the temptation to actively court government favor as short-run business interests dictate. The widely recognized "forest problem" of pervasive special-interest interferences with the market is really a "trees" problem of political opportunities to individual businesses. Cain, a man "not comfortable in either political party," never found himself in a business predicament of having to exercise the political means to get ahead. And he never forgot the lessons from a slim book he read when it was published in 1944: Hayek's *Road to Serfdom*. Now, with his newfound fortune, a personal lifestyle that has remained unchanged (except for a private plane that he apologizes for in the book), and a quest to improve society in the near term, he scoured the think-tank spectrum for foundations supporting limited government and libertarian ideals.

Cain's story offers much useful insight and experience about business restructuring, management philosophy, and public policy. Cain's revisionism casts fourth-and-long business restructuring in new light. Debt financing is shown to have a human face after all. And thanks in part to Cain's new competitive standard, America's chemical/petrochemical industry remains a world leader today. *Everybody Wins!* is thus a powerful antidote to many poisonous myths about capitalism. □

Mr. Bradley is president of the Institute for Energy Research in Houston, Texas.

Dynamics of the Mixed Economy: Toward a Theory of Interventionism

by Sanford Ikeda

Routledge • 1997 • xiv+296 pages • $69.95

Reviewed by E. C. Pasour, Jr.

In *Dynamics of the Mixed Economy,* a mixed economy is defined as any political-economic system that lies between the extremes of laissez-faire capitalism and pure collectivism. In a critique of interventionism published in 1929, Ludwig von Mises found the mixed economy to be contradictory, illogical, and inherently unstable. This finding, coupled with what we observe throughout the world, poses what is referred to in this book as the "Misesian paradox"—how can a mixed economy subject to these grave defects continue to be the most widespread and persistent form of political-economic system in the world today?

Ikeda extends Mises's work in light of recent developments in market process theory to provide an explanation of the tendency of the state to expand and contract—swinging back and forth toward either more or less government control. The book draws heavily upon work by F. A. Hayek and Israel Kirzner—especially Hayek's notion of the spontaneous order and insights about the use of knowledge in society and Kirzner's concept of entrepreneurial discovery and critique of equilibrium analysis in mainstream economic theory. Readers not familiar with the ideas of Mises, Hayek, and Kirzner will find this book to be a hard read.

Why is it, as Mises argued, that government intervention tends to lead to outcomes that are inferior, as measured by the interventionist's own standards? Ikeda traces the unintended consequences to three factors—dispersed knowledge (discussed by Hayek a half century ago), radical ignorance, and systemic complexity. The interaction between government and market processes magnifies the problems created by dispersed knowledge and radical ignorance as the relative size of the public sector increases.

Moreover, the act of intervention itself weakens the moral aversion or psychological resistance to statism, further contributing to the growth of the public sector. In the case of direct income transfers, for example, intervention fosters a mentality of dependency and personal irresponsibility.

Further government action is then taken to cope with intervention-spawned problems. When the results of interventionism become sufficiently perverse, the mixed economy reaches the crisis stage and governmental officials must make a radical move—either toward more or less intervention. Despite the contradictions and instability, Ikeda concludes that the mixed economy will tend to be the most prevalent form of political-economic system and is likely to be more enduring than either pure collectivism or capitalism.

What are the implications for controlling Leviathan? While the inner contradictions of interventionism can be eliminated only by eliminating the state, Ikeda holds out some hope for a less drastic approach—the minimal state. The inherent tendency of government to grow in the minimal state can be overcome, he suggests, if the ideological preferences of public choosers for limited government are sufficiently strong.

Decision-makers in the political process face two kinds of problems: incentive problems, the focus of public choice theory; and knowledge problems, Ikeda's primary concern and that of Austrian political economy generally. In *Dynamics of the Mixed Economy,* Austrian and public choice

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approaches are considered to be complementary but independent. This position, however, cannot withstand careful scrutiny.

The likelihood of increases or decreases in government intervention at any particular time is not independent of the institutional framework. The kinds of political structures and procedures in place, as emphasized in constitutional political economy (a public choice subdiscipline), can profoundly affect both the amount of transfer-seeking intervention and the likelihood that political decision-makers will act in ways consistent with the interests of the public-at-large.

Dynamics of the Mixed Economy contains a wealth of insights on the perils and results of government intervention—it also provides some hope for advocates of a free society. A strong ideological commitment of public choosers to limited government—preferences rooted in political philosophy, morality, and religion—can provide an institutional framework conducive to policies consistent with that goal. However, Ikeda is silent on the really important question—how can we achieve a consensus in favor of limited government? □

Dr. Pasour is professor of agricultural and resource economics at North Carolina State University, Raleigh.

Everything for Sale: The Virtues and Limits of Markets

by Robert Kuttner

Alfred A. Knopf • 1997 • 410 pages • $27.50

Reviewed by Raymond J. Keating

Robert Kuttner's *Everything for Sale* carries the subtitle *The Virtues and Limits of Markets*. Unfortunately, Kuttner sees few, if any, virtues and many limits when it comes to free markets.

Of course, it will surprise few that Kuttner holds this view. After all, he is a ubiquitous, outspoken proponent of big government. Open a newspaper, a magazine, or turn on a public-policy-oriented television show, and chances are unusually high you will come across Robert Kuttner.

In television sound bites and his rather short newspaper columns, Kuttner manages to sound naïve, misguided, misinformed, and even dangerous, all at the same time. What *Everything for Sale* clearly demonstrates is that such cloudy thinking is not a function of the medium, but lies at the core of big-government liberalism.

In *Everything for Sale*, Kuttner conveniently argues against his own perverse, ill-informed ideas of what free markets are all about, forcing the reader to plod through a field of straw men which the author delights in knocking down. The most obvious of these straw men is his attack on perfect competition. Kuttner wrongly asserts that market proponents view the perfect competition model as a reflection of market realities; then he shows that markets are not perfectly competitive, proclaims market failure, and calls for widespread government intervention.

In reality, of course, few if any, economists see perfect competition as a reflection of actual markets. Indeed, most freshman economics students quickly understand this fact. As James Gwartney and Richard Stroup explain in their fine, market-oriented textbook *Economics: Private and Public Choice*, perfect, or pure, competition is an abstract, simplified model whose purpose is to "help us develop the economic way of thinking." Beyond perhaps certain parts of the agriculture industry, this model has little direct application to the dynamic, day-to-day functioning of actual markets. However, the constant use of the perfect competition model in economics instruction, I think, can confuse people outside the economics profession, and apparently, as exemplified by Kuttner, a few inside it as well.

Kuttner also suffers from serious lapses in logic. Much of his case for continuing to regulate such markets as health care, banking, finance, labor, and so on, rests on nothing more than the idea that these markets have long been highly regulated. In the case of health care, for example, he goes so far as to assert inanely that true market reform "turns out to require massive government regulation."

All of the trite liberal views of the marketplace are given full voice in Kuttner's book. The author sees markets *only* producing winners and losers. He seems incapable of grasping the fact the market produces winners on both ends of each transaction—both buyers and sellers are better off.

In Marxist fashion, Kuttner vastly discounts the critical aspect of individual freedom in the marketplace, favoring bankrupt notions of class warfare and exploitation instead. And, of course, in contrast to centuries of economic progress through free markets, the author believes that markets are inherently short-term in outlook, yet offers no evidence in support of this thesis. In addition, while Kuttner criticizes free-market economists for applying economic analysis to noneconomic decisions (a criticism that may apply to some but certainly not the majority of such economists, despite what Kuttner implies), he fails to consider the impor-

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tance of incentives in his own analysis of straightforward economic decisions.

There is much in this book to identify the author as an extremist when it comes to his opposition to free markets and in his support of government action. Consider the following statements:

- "Yet in a Keynesian sense the war [i.e., World War II] was stunningly efficient."
- "Trust, civility, long-term commitment, and the art of consensual deliberation are the antithesis of pure markets, and the essence of effective politics."
- "[W]e need the habits and institutions of a strong democracy *precisely to keep markets in their place* and to provide resilience during those historical periods when the market goes haywire and makes ordinary people vulnerable to the appeals of tyrants."
- "In this century, the expansion of state constraints on the market and the expansion of the province of personal liberties have gone hand in hand."

Oddly, for the free-market reader, *Everything for Sale* is at once both frustrating and encouraging. The book frustrates due to its misrepresentations and misunderstandings of the workings and benefits of markets. However, the book proves to be so intellectually bankrupt that it should encourage those looking to advance economic freedom. If this is the best the opposition has to offer, free-market economics is in a much better position than many of us might previously have thought. □

Mr. Keating is chief economist for the Small Business Survival Foundation and author of New York by the Numbers: State and City in Perpetual Crisis *(Madison Books, 1997).*

A Sacred Union of Citizens—George Washington's Farewell Address and the American Character

by Matthew Spalding and Patrick Garrity

Rowman & Littlefield • 1996 • 217 pages • $27.95

Reviewed by George C. Leef

Of all the Founders, George Washington is the most famous, but arguably the least well known. Washington's life is well chronicled, but when it comes to his thought, he is largely a mythic figure. People carefully study the writings of Jefferson, Madison, Hamilton, *et al.,* but as for Washington, he is known almost entirely for his deeds—defeating Cornwallis, presiding over the Constitutional Convention, serving as the first president—rather than for his words. What did he *believe*?

A Sacred Union of Citizens by Matthew Spalding (director of lectures and educational programs at the Heritage Foundation) and Patrick Garrity (senior fellow at the Claremont Institute) helps to answer that question by focusing on Washington's most famous writing, his Farewell Address. The authors have produced a lovely volume that sheds a great deal of light on Washington's own character and his hopes for a national character that would emerge in his countrymen. There are many good biographies of Washington, but for a vision into the workings of his mind, this book is an excellent beginning point.

The book is structured around the Farewell Address, its history and meaning. Interestingly, Washington did not actually deliver the address; rather, he sent it to Philadelphia's *American Daily Advertiser,* where it was published on September 19, 1796. The message was the culmination of Washington's public life and in it he painstakingly expressed (the authors even discuss some of the material he deleted and reproduce part of the handwritten manuscript showing some excisions) his counsel to the nation he had done so much to create. In fact, the Farewell Address is a lot like Washington himself in that many people have heard of it, but few know much about it. Many politicians, for instance, can tell you that in it, Washington advised against foreign alliances and interference in the affairs of other nations, but would be hard-pressed to relate any other idea contained in the Farewell Address.

For their benefit, here is one. The problems of political parties and factionalism concerned Washington as much as did the dangers of foreign entanglements. In Paragraph 21 (the entire Address consists of 50 paragraphs) he writes, "The alternate domination of one faction over another sharpened by the spirit of revenge natural to party dissension, which in different ages and countries has perpetuated the most horrid enormities, is itself a frightful despotism." How very true.

Unfortunately, Washington did not immediately give a prescription for the avoidance of these evils, but elsewhere in the Farewell Address, Washington extolled the virtues of just minding one's own business. If the character of most if not all of the people were to be formed around that simple maxim, people would turn away from the seduction of politics.

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Washington also warned in the Farewell Address against allowing even the slightest weakening of the Constitution's restraints upon governmental power, writing, "But let there be no change by usurpation; for though this, in one instance, may be the instrument of good, it is the customary weapon by which free governments are destroyed. The precedent must always greatly overbalance in permanent evil any partial or transient benefit which the use can at any time yield." Alas, many members of the Supreme Court have been willing to ignore Washington's counsel, if they know of it at all. The Constitution's limits on government power have been shredded, thanks to the arrogance of justices who thought that achieving what they regarded as socially good results was more important than preserving the Constitutional plan of limited government based on a few enumerated powers and many unyielding restrictions.

Readers who take up this book expecting to find unfailing Washingtonian support for minimalist government will, however, be disappointed. The authors note that he favored the establishment of a national university, for example, not seeing the long-run dangers of allowing the government to become active in the provision of education. He also favored a national bank and held an ambivalent attitude toward foreign trade, maintaining that the nation might develop better if the people produced more of their own goods. Bastiat came along half a century too late to have enlightened our First President on the folly of government involvement in any of these areas.

A Sacred Union of Citizens is an intriguing project, well executed. For Americans interested in learning more about the workings of George Washington's mind, this book is indispensable. □

Mr. Leef is the book review editor of The Freeman.

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